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CHARLES ELMO

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1932

No. 564

F. E. BUFFUM, as Trustee in Bankruptcy of Henry Joseph Barceloux, Bankrupt,
Petitioner,

vs.

PETER BARCELOUX COMPANY (a corporation),
Respondent.

BRIEF OF PETITIONER AFTER WRIT OF CERTIORARI GRANTED.

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Subject Index

	Pages
Opinions of courts below	1
Jurisdiction	2
Statement of the case	3 - 12
Specification of errors	12 - 15
Summary of argument	15 - 17
Argument	17 - 78

A.

The Circuit Court of Appeals erroneously construed Section 70e of the National Bankruptcy Act by reversing the decree of the trial court for money, thereby denying to the trustee, petitioner here, the election to recover value in a suit brought under said section; and in denying a money decree for value under facts appearing in the record which made that the only relief which was possible ..... 17 - 33

B.

In a federal equity appeal, no new evidence can be received (U. S. Rev. Stat. Section 698; U. S. Code Tit. 28, Section 863) ..... 33 - 39

C.

There is no jurisdiction in a federal court of equity in a controversy arising out of bankruptcy to adjust the priorities and distribute the proceeds of the property of the bankrupt estate, that being the exclusive province of a court of bankruptcy under National Bankruptcy Act, Sections 2 (7), 47 (a), (2) and 70 (b), (c) ..... 39 - 41

D.

The trustee is not precluded, in a suit on behalf of all creditors, from asserting that a transfer was fraudulent by the fact that one of the creditors took additional security which recited the existence of the transfer assailed as fraudulent ..... 42 - 46

E.

Pages

Under the law of California, a corporation of that state is prohibited from acquiring its own issued shares except under circumstances none of which appear in this record (California Civil Code, Section 309, in force in 1926) 47-49

F.

It was error for the Circuit Court of Appeals to assume jurisdiction over the 2499 shares of respondent Peter Barceloux Company's stock by reason of the mere introduction of certain cancelled certificates in evidence 50-52

G.

The sale by the corporation of the stock acquired at a pledge sale held invalid constituted a conversion and therefore the money judgment was proper and should have been affirmed for that reason 53-56

H.

The decision of the Circuit Court of Appeals ignored the trial court's finding that the pledge of April 27, 1926, was void as to creditors for want of immediate delivery and a continued change of possession as required by Section 3440 of the Civil Code of the State of California 56-62

I.

The trial court's findings of fact should not be reversed on appeal when based upon the testimony of witnesses heard and observed by the trial judge, and also based on written evidence consistent with his findings and inconsistent with contrary findings 62-78

Conclusion 79

Table of Cases Cited

Pages

American Mills Co. v. American Surety Co., 260 U. S. 360 54
Atkinson v. Golden Gate Title Co., 21 Cal. App. 168, 172 74

Barr v. Smith, 97 Cal. App. 398..... 76
Barger v. National Discount Corp., 33 F. (2d) 511..... 77
Becker v. Beldt, 205 Cal. 491 at 494.....65, 66, 72
Bell v. Bank of California, 153 Cal. 234, 238..... 55
Blease v. Garlington, 92 U. S. 1, 4..... 33
Brainard v. Cohn (Ninth C. C. A.), 8 Fed. (2d) 13, 15... 19
Burke v. Badlam, 57 Cal. 594, 601..... 52

Casey v. Cavaroc, 96 U. S. 467, 486.....60, 61
Christian v. Atlantic & N. C. R. R. Co., 133 U. S. 233, 241 61
Coder v. Arts, 213 U. S. 242, 243, 244..... 65

Davis v. Gates, 235 Fed. 192..... 66
Davis v. Schwarz, 155 U. S. 631, 638..... 71
Dean v. Davis, 242 U. S. 438, 444..... 65
Delk v. St. Louis & S. F. R. Co., 220 U. S. 580..... 79
Dibert v. Wernicke (Sixth C. C. A.), 214 Fed. 673, 683 (identical facts) 55
Dodd v. Raines, 1 Fed. (2d) 658 at 660..... 44
Dunphy v. Kleinschmidt, 11 Wall. 610.....32, 33

Evans v. Sparks, 170 Cal. 532, 534..... 71

Fee v. McPhee Co., 31 Cal. App. 295, 314..... 74
Feilbach Co. v. Russell (Sixth C. C. A.), 233 Fed. 412 414, 415.....29, 55
Flanders v. Coleman, 250 U. S. 223, 229..... 44
Franklin Bank v. Harris, 77 Md. 423..... 75

Globe Bank & Trust Co. v. Martin, 236 U. S. 288, 304.... 41
Grover v. Smith, 165 Mass. 132, per Holmes, J., on authority of Brickett v. Wallace, 98 Mass. 528..... 38

Harvey v. Stowe (Ninth C. C. A.), 219 Fed. 17, 22.....60, 61
Harkin v. Brundage, 276 U. S. 36, 53..... 78
Hedrick v. Hockfield, 283 Fed. 574..... 72
Henning v. Akin, 91 Cal. App. 246, 255, 256..... 55

Pages

Irving Trust Co. v. Siroty (Second C. C. A.), 60 Fed. (2d) 71 30
Isaacs v. Hobbs Tie & Timber Company, 282 U. S. 734, 738, 739 41

Jaffray v. Wolf, 4 Okl. 303..... 74
Jean v. Jean, 207 Cal. 115, 120, 122..... 52
John T. Porter Co. v. Java Coconut Oil Co., 4 F. (2d) 476 67
Johnson v. Peoples State Bank, 22 Fed. (2d) 211 at 213 55
Jones v. Jones, 35 Fed. (2d) 943, 945..... 67

Keller v. Potomac Electric Power Company, 261 U. S. 428, 444 38
Keller v. Fowler Bros. & Cox, 148 Tenn. 571..... 44

Lane v. Pueblo of Santa Rosa, 249 U. S. 110, 114..... 37
Lowe v. Ozmun, 3 Cal. App. 387, 394 (identical facts)... 55
Luce, In re, 83 Cal. 303..... 64

Mann v. Appel, 31 Fed. 378..... 33
McFall v. Buckeye etc. Assn., 122 Cal. 468, 470.....60, 61
Monson v. Hibler (Ninth C. C. A.), 24 Fed. (2d) 909, 910 67
Moore v. Bay, 284 U. S. 4.....21, 45
Muller & Kennedy, In re, 118 Cal. 432..... 64

National City Bank v. Hotchkiss, 231 U. S. 50 at 59, 58 L. ed. 119 25

Old National Bank v. Heckman, 148 Ind. 490, 507..... 46
Oliver v. Brennan (In re Wright Motor Company), 299 Fed. 106, 108.....19, 49
Ostbern v. Dean (Ninth C. C. A.), 18 Fed. (2d) 1019, 1020 67

Payne v. Elliot, 54 Cal. 339, 340..... 51
People v. Robinson, 107 Cal. App. 211 at 220..... 54
Phelps, In re, 3 Am. Bank. Rep. 396, 399, 403..... 26
Porter Co., John T., et al. v. Java Coconut Oil Co., Ltd. (Ninth C. C. A.), 4 Fed. (2d) 476, 478, certiorari denied, 268 U. S. 697-698..... 67

Ralston v. Bank of California, 112 Cal. 208..... 47
Realty Acceptance Corp. v. Montgomery, 284 U. S. 547, 549 .....33, 37
Rethalulew, Official No. 227860, 51 Fed. (2d) 646..... 34

Pages

Roberts v. Burr, 135 Cal. 156 64
Roemer v. Simon, 91 U. S. 149, 150 33

Schainman v. Dean, 24 Fed. (2d) 475, 476 19
Schock v. Malloy, 26 F. (2d) 621, 623 77
Shapiro v. Wilgus, ... U. S. ..., Oct. Term, 1932 .....70, 71
Stevens v. Boyes Hot Springs Company, 113 Cal. App. 479, 482 .....47, 48
Stewart v. Stewart Hotel Company, 33 Cal. App. 167, 182 48
Sukeforth v. Lord, 87 Cal. 399 72

Turner v. Jacobs (Fifth C. C. A.), 15 Fed. (2d) 350, 352 73
Twist v. Prairie Oil & Gas Co., 274 U. S. 684 54

Van Iderstine v. National Discount Co., 227 U. S. 575, 582 65

Wagg v. Toler, 80 Cal. App. 501, 510 48
Wolbrecht v. French, 24 Cal. App. 505, 508 .....64, 65, 72

Youngs Rubber Co. v. C. I. Lee & Co. (Second C. C. A.), 45 Fed. (2d) 103 33

Table of Statutes Cited

Pages

California Civil Code:
Section 309 (App. p. ii) 16, 47, 49
Section 342 (App. p. iii) 47
Section 2988 (App. p. iv) 60
Section 2993 (App. p. iv) 61
Section 3432 (App. p. iv) 64
Section 3439 (App. p. i) 45
Section 3440 (App. p. i) 16, 45, 56, 60, 61
Section 3450 73

California Code of Civil Procedure (App. p. iv) 76

National Bankruptcy Act:
Section 2 (7) 13, 15, 39, 40
Section 47 (a) 2 .....13, 15, 22, 39, 40
Section 60b 24, 25, 26, 29
Section 67e 23

National Bankruptcy Act (cont'd): Pages
Section 70 (a) 5 54
Section 70 (a) 6 54
Section 70 (b) 13, 15, 39, 40
Section 70 (c) 13, 15, 39, 40
Section 70e 2, 5, 12, 13
15, 17, 18, 19, 20, 21, 22, 23, 24, 25, 27, 28, 32, 45, 46

U. S. Rev. Stat.:
Section 698 ..... 15, 33, 38
Section 1011 38
Section 1012 38

U. S. Code Tit. 28:
Section 863 ..... 13, 33, 38
Section 877 79
Section 879 38
Section 880 (Supp.) 38

Act of Congress, March 3, 1891, c. 517, § 10 79

Act of Congress, March 3, 1891, c. 517, § 11 36

26 Stat. 829 36

Act of Congress, 1803 (2 Stat. 244) 36

New Equity Rules 22 3
23 54
29 36
30 36
70½ 3

Textbooks and Encylclopedias

Collier on Bankruptcy: Page
8th ed. 1910 at page 675 26
1925 ed. at page 1330 26
1925 ed., page 1782 44

Jones on Mortgages, Eight Edition, Volume 2, Section 912, page 256 46

12 California Jurisprudence 1012 64

Bump on Fraudulent Conveyances, Sections 612, 613, pages 590, 591 69

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BRIEF OF PETITIONER AFTER WRIT OF CERTIORARI GRANTED.

I.

OPINION OF THE COURTS BELOW.

The opinion of the United States District Court in and for the Northern District of California, Northern Division, in the above entitled cause, is reported in 51 Fed. (2d) at page 80, and the majority opinion of the Circuit Court of Appeals for the Ninth Circuit,

reversing the decree of the said District Court with directions, and also the dissenting opinion of Judge Sawtelle, are reported in 61 Fed. (2d) at page 145.

II.

JURISDICTION.

The grounds on which the jurisdiction of this Court rests, and also the grounds on which the jurisdiction of the trial Court and the Circuit Court of Appeals rests, have already been stated in the petition for *certiorari,* at page 15 of the supporting brief of petitioner, and this being believed to be a sufficient compliance with Rule 27 of this Court, the same is not repeated, but is here referred to for all purposes to the same effect as if it were here set out in full.

Supplementing that statement, it may be said that the jurisdiction in equity is founded upon Section 70e of the National Bankruptcy Act, because it is necessary to avoid a fraudulent transfer, made more than four months previous to the adjudication of the transferor as a bankrupt, which is the province of equity jurisdiction.

In view of certain arguments made in the Circuit Court of Appeals, it may be stated that the case was tried as an equity case (R. 462, bottom of page, majority opinion), and as found by Judge Sawtelle in the dissenting opinion (R. 485, *et seq.*), the appellant, respondent here, admitted that the trial Court had jurisdiction to determine this suit on the equity side (R. 484). The answer (R. 14, 28) contains no

defense in matter of law that the case is not one in equity and should be tried at law, and no motion to transfer was made in the trial Court, pursuant to Equity Rule 22, or otherwise.

III.

STATEMENT OF THE CASE.

The case is here on *certiorari* after an appeal to the Circuit Court of Appeals for the Ninth Circuit in equity, from a decree made and entered in the United States District Court for the Northern District of California, Northern Division, in favor of the petitioner, complainant below, and against the respondent, defendant below, the suit being one filed by the petitioner, as trustee in bankruptcy of Henry Joseph Barceloux, a bankrupt, against the respondent, Peter Barceloux Company, a corporation.

George R. Freeman, as administrator of the estate of Frank Freeman, deceased, was originally made a codefendant with the respondent herein; but by his consent and without objection was dismissed (R. 29) and the case proceeded to trial with your petitioner, plaintiff below, and respondent, defendant below, as the only parties in the case. Wherever in this brief George R. Freeman is mentioned, it will be understood that he is spoken of only as administrator of the estate of Frank Freeman.

The decree of the District Court having been entered on September 19, 1930, before New Equity Rule 70½ went into effect, there are no findings of

fact conforming to that rule, but the final decree (R. 101) refers to and adopts as findings of fact and conclusions of law the opinion of the trial Court dated July 25, 1929, and filed July 29, 1929, which appears on R. 30 to 35, inclusive.

On appeal to the Circuit Court of Appeals for the Ninth Circuit, that Court after argument and a reargument ordered on its own motion reversed the decision of the District Court by a majority of a divided Court (R. 456-483), Circuit Judge Sawtelle, dissenting (R. 483-504), and a petition for a rehearing in the Circuit Court of Appeals was denied (R. 507).

Henry Joseph Barceloux was adjudicated a bankrupt on February 25, 1927 (R. 3, 15). This suit was brought on April 3, 1928 (R. 14). The bill of complaint seeks to avoid certain transfers made by the bankrupt to the respondent, Peter Barceloux Company, at a time when the bankrupt was president thereof, to-wit: a certain purported pledge (bearing date, April 27, 1926) of his 2499 shares of the respondent corporation's stock, seeking to secure a preexisting indebtedness, also a subsequent purported pledge of shares of other corporations as additional security for the same indebtedness, and also the bill seeks to avoid the purported pledge sale of all said shares, all of which transactions were alleged to have been made with intent to hinder, delay, and defraud the many non-kindred creditors of said bankrupt then or thereafter existing (R. 2-13, Bill of Complaint).

The bill alleged that the shares, which were purchased by the respondent at its own purported pledge

sale, were later transferred by it to George A. Barceloux. The Trustee sought by his said bill not the return of the property so fraudulently transferred, but its value, based on the right of election given such Trustee under the provisions of Section 70e of the National Bankruptcy Act, and also because such was the only recovery available to him in that the shares had been theretofore transferred to George A. Barceloux, who at the time of the filing of the bill held and possessed the shares as owner.

The respondent, without filing a motion to dismiss or a motion to make the bill more definite and certain, answered said bill, denying the fraud and averring that the transactions were all *bona fide* and for a valuable consideration (R. 18), and further, admitted that the respondent had transferred the shares to George A. Barceloux, but denied by a negative pregnant that "the said George A. Barceloux has at all times thereafter, and still does, purport or claim to hold and possess said securities as owner thereof" (R. 26).

The case was tried upon said issue so made before the said United States District Court, and said Court made and entered its interlocutory decree, finding that all of said transfers were fraudulent and void, as alleged in the bill, and decreeing that the same be avoided, and referred the cause to an auditor and master to determine the highest aggregate value of said properties during the period commencing August 16, 1926 (the date of the purported pledge sale), to and including the date of the filing and approval of the audit and report of said auditor or master (R. 45).

Said master and auditor, after due proceedings had, rendered and filed his audit and report, fixing the highest aggregate value in the sum of $106,409.44, and thereafter a final decree was made and entered pursuant to said interlocutory decree and the master's audit and report (R. 49-61). The said auditor or master found the value of all the said properties at the time of the alleged pledge sale (August 16, 1926) to be the sum of $97,107.66 (R. 61).

The remaining facts necessary to state the case touch upon the issues of fraud and because of their complexity will be stated in a chronological narrative as the best means to insure the utmost possible conciseness.

In the Spring of 1926, Henry Joseph Barceloux (the bankrupt) was a man of large operations in banking, real estate, ranching, etc., and had arrived at the crisis of his affairs. He had extensive properties and likewise large debts. As found by the lower Court, his properties were of a value of $180,000.00, and his debts, which were owing to many creditors, amounted to the sum of $191,000.00 (R. 34). At that time his only substantial unencumbered asset was his shares (2499) in the respondent Peter Barceloux Company (R. 420-426). Said company was a family corporation organized in 1912 by Peter Barceloux, the father of the bankrupt, for the purpose of owning and operating all of his properties, which he transferred to it for all of its corporate stock, which stock was immediately distributed in four equal parts to his two sons, George and Henry Barceloux, his daughter, Cora Gelinas, and three children of a deceased

son (R. 296). The bankrupt was president of the company from its incorporation until he resigned on July 28, 1926, although during the lifetime of Peter Barceloux (who died in 1918), Peter managed said properties (R. 464).

In 1921 one Frank Freeman secured a judgment against Henry Barceloux and one Donohoe, which became final in 1924 (R. 400), and in 1926 there was owing upon said judgment the total sum of $58,000.00. Upon said judgment becoming final in 1924, George Freeman, as administrator of Frank Freeman, deceased, together with the bankrupt and the bankrupt's attorney, entered into an agreement whereby all of said parties were to cooperate to the end that a large portion of said judgment might be satisfied from the estate of Donohoe (R. 371). Donohoe, immediately after the finality of said judgment, was adjudicated a bankrupt (R. 376). Under such agreement the bankrupt promised to refrain from hypothecating, encumbering or transferring any of his properties (R. 371-372), and in consideration thereof George Freeman, as such administrator, was to forbear issuing execution against any of Barceloux's properties (R. 376). In the Spring of 1926 it became apparent that all endeavors against the bankrupt estate of Donohoe would be unsuccessful and that the obligation of satisfying said Freeman's judgment would rest solely upon Henry Barceloux. Thereupon commenced a sequence of events and transfers whereby all of Henry Barceloux's assets (of a value of $180,000.00) were transferred to the respondent family corporation and to other members of Henry's family, and on

February 25, 1927, when Henry filed his voluntary petition in bankruptcy, he, as found by the lower Court (R. 33) and as expressed by Judge Sawtelle (R. 489, dissenting opinion) had "no property left of any kind" to satisfy demands of his many non-kindred creditors, all of which clearly discloses a plan to " 'freeze out' non-kindred creditors from the family corporation's stock" and from the rest of Henry's assets.

These events, stated in sequence and as briefly as possible, were as follows without any dispute or conflict, except as to those herein stated to have been upon the testimony or "claims" of members of the Barceloux family.

1. Because of the demands of Freeman for payment or security upon said judgment (R. 304), the respondent corporation demanded of Henry a pledge of his shares in the family corporation to secure certain indebtednesses claimed to be owed to the respondent. On April 27, 1926, according to testimony of the Barcelouxs, the bankrupt brought with him to a purported meeting of the directors of the respondent his certificate representing his 2499 shares in the respondent corporation, bearing a blank endorsement, and also a blank pledge agreement. At said meeting it is claimed by the respondent that the blanks of said pledge agreement were filled out by the bankrupt to recite the pledge of his said 2499 shares to secure three items of preexisting indebtedness, claimed to be then owing to the corporation, totalling the sum of $27,814.48. After said meeting the bankrupt took with him said certificate and signed pledge agree-

ment (R. 309, 337), retaining both in his possession, as he claims, with other corporate records until he resigned as president on July 28, 1926 (R. 337). Said shares were found by the auditor, as of August 16, 1926, to be of the value of $94,949.66.

2. In the Spring of 1926, Freeman was seeking from the bankrupt security for the payment of said judgment, and succeeded on June 30, 1926, in obtaining from the bankrupt a deed of trust covering certain lands, which the bankrupt owned in common with his brother, George, subject to a substantial mortgage, the interest of Henry, the bankrupt, in said lands being already subject to a judgment lien in favor of Freeman; and at the same time the bankrupt assigned to Freeman, by way of pledge, his 2499 shares of the respondent corporation's stock, which the bankrupt told Freeman had been for a long period of time, and still was, subject to a prior pledge to the respondent corporation to secure a note in the sum of $24,000.00 (R. 402), but Henry, the bankrupt, did not reveal to Freeman that said shares were only recently pledged (April 27, 1926), in direct violation of his agreement not to so hypothecate his said properties. Freeman then sought from the respondent corporation an agreement that its pledge would not be foreclosed save after ninety days' notice to Freeman (R. 405), which agreement was refused (R. 409). The bankrupt testified that the assignment and purported agreement created a family "fuss," and that George Barceloux and Cora Gelinas wanted additional collateral and he gave it to them, and after that "they sold the stock and everything" (R. 368).

3. The respondent corporation executed to itself a certificate (bearing No. 12) covering said 2499 shares in its name as pledgee (Exhibit No. 3). Said certificate, which was dated June 29, 1926, and was taken, as stated, by George Barceloux, for the reason that he heard that Freeman got a deed of trust from the bankrupt on the Lake County Ranch and had recorded it. The deed of trust, however, was executed on June 30, 1926, and was recorded on July 3, 1926 (see Exhibit No. 16), four days later than the antedated Certificate No. 12 (see R. 32, and also R. 489, dissenting opinion by Judge Sawtelle).

4. On July 3, 1926, the Peter Barceloux Company obtained a pledge from the bankrupt of his remaining unencumbered properties, to-wit, his bank, insurance, and garage shares, valued by the master at $2158.00, as additional security for the indebtednesses that were already secured by the pledge agreement bearing the date of April 17, 1926, covering securities having a value of $94,000.00, more than three times the value of the indebtedness (R. 354).

5. On July 7, 1926, the bankrupt conveyed to his wife his equity of the value of some $2900.00 in some lands, for the purported consideration of $1000.00 (R. 355-356).

6. On July 28, 1926, the bankrupt sold his qualifying share in the respondent corporation to Cora Gelinas (sister) for $10.00, and resigned the presidency of the respondent corporation, which he had held for fourteen years (from its incorporation) (R. 370).

7. On August 16, 1926, the respondent corporation assumed to foreclose the pledges above described at a purported "public sale," held quietly without notice to Freeman or other creditors of the bankrupt, with scant or no publicity or outcry (R. 317, 323), and there offered all of the shares covered by the said pledges of April and July, 1926, *en masse,* and sold the same to itself for one consideration in payment of the three items of indebtedness recited in the written pledge agreement, together with three other items totalling the sum of $5929.00, which were not described or referred to in the written pledge agreement (R. 317). This sale was found fraudulent by the trial Court (R. 34), and in the majority opinion of the Circuit Court of Appeals it was said:

> "Such conduct does not appeal to the conscience of the chancellor" (R. 473).

8. On August 24, 1926, for the purported consideration of $2000.00, the bankrupt transferred to his sister, Cora Gelinas, certain bank shares, having a value of $24,100.00 and subject to a pledge in the amount of $13,800.00 (R. 389, 33), and on the same day the bankrupt made a substantial deposit to his son's account for "school expenses" (R. 371) and paid his son $1000.00 on account of a note dated 1915 and long outlawed, which was payable to the bankrupt's mother-in-law (R. 371).

9. In September, 1926, the respondent corporation assumed debts of the bankrupt in the amount of $16,000.00 owing to Crocker First National Bank of San Francisco, and took over all of his collateral security given therefor (R. 360, 361).

10. In October, 1926, the bankrupt transferred certain personal property to his attorney (R. 425).

After the date of the last transfer, the bankrupt had assets remaining which were listed in the inventory and appraisement filed by the trustee with the referee in bankruptcy, to whom the administration of said bankruptcy matter was referred, totalling approximately $652.18 (Complainant's Exhibit No. 23), or, as the bankrupt testified, "he had no property left of any kind" (R. 33, 489).

The bankrupt then, after waiting for a period exceeding four months, filed on February 25, 1927, a voluntary petition in bankruptcy.

IV.

SPECIFICATION OF ERRORS INTENDED TO BE URGED.

1. The Circuit Court of Appeals erred in denying the right of plaintiff to elect to sue for a recovery of the value of the shares of stock under National Bankruptcy Act, Section 70e, in a suit in equity, where, as appeared in this suit, defendant (after parting with all title to said shares) after issue joined, had repossessed itself of the certificate for said shares endorsed for transfer; and the Court erred in holding that under these circumstances a decree for recourse to the shares in specie was the only permissible relief, thus misconstruing said Section 70e and denying the right thereby given to this plaintiff to elect to seek value.

2. The Circuit Court of Appeals erred in entertaining a tender of the 2499 shares of the defendant's stock (being only a part of the shares pledged and involved) and in entertaining an offer of a release to be made by George A. Barceloux (not a party to this suit), which tender and offer of release were made for the first time on appeal, and as made, were contrary to the defenses and claims of full and valid legal title in the defendant made in its answer with a prayer that title be quieted and declared to be good and valid in it, the said action of the Circuit Court of Appeals being the reception of new evidence on appeal contrary to U. S. Code, Title 28, Section 863.

3. The Circuit Court of Appeals erred in assuming a jurisdiction belonging to a Court of bankruptcy, in that the decision of said Court undertakes to determine priorities and distributive rights in the 2499 shares ordered to be resold under the alleged pledge, in this suit in equity brought under National Bankruptcy Act, Section 70e, the jurisdiction of the bankruptcy Court to adjudge priorities being exclusive by virtue of National Bankruptcy Act, Sections 2 (7), 47 (a) (2), and 70 (b), (c).

4. The Circuit Court of Appeals erred in holding creditor Freeman estopped to assert fraud in the alleged pledge by reason of his having taken additional junior security, and in holding that plaintiff trustee, suing for all creditors, was also estopped by reason of Freeman's supposed estoppel and the elimination of all question of fraud thereby.

5. The Circuit Court of Appeals erred in holding that the defendant could, under the law of California,

resume title to its own shares by a voluntary retransfer to it after a sale of absolute title, without any evidence in the record to show that such retransfer was made to save itself from loss because of the insolvency of the purchaser, or his inability to pay the agreed price to the defendant, and without any evidence of any other fact which in law justifies such acquisition of its own shares.

6. The Circuit Court of Appeals erred in assuming to have jurisdiction over the 2499 shares of defendant's stock by reason of the introduction of the cancelled certificate No. 5 (Defendant's Exhibit No. 3, the stock book with certificate attached), which was put in evidence by plaintiff as proof bearing on fraud; and because George A. Barceloux, the transferee of and retransferor to defendant of the said shares, was not a party to this suit and hence would not be bound by the decree in that respect.

7. The Circuit Court of Appeals erred in reversing the decree of the trial Court for the value of the 2499 shares at the time of the purported pledge sale, contrary to its own finding that title to said shares was revested in defendant by the retransfer of the shares to it, disregarding thereby that the sale by it to George A. Barceloux was in law a conversion by the pledgee in repudiation of the pledgor's general property sufficient to sustain the decree as made.

8. The Circuit Court of Appeals erred in law in holding and finding that the purported delivery of the certificates by the pledgor to himself as president of pledgee corporation, himself keeping exclusive possession, constituted a valid pledge as against creditors.

9. The Circuit Court of Appeals erred in law in rejecting the trial Court's findings of fact that there was fraud in the alleged pledges, which findings were based on oral evidence of witnesses heard and observed by the trial judge, and also based on written evidence consistent with his findings and inconsistent with the Appellate Court's finding that the pledge was in good faith.

V.

ARGUMENT.

SUMMARY OF THE ARGUMENT.

A. THE CIRCUIT COURT OF APPEALS ERRONEOUSLY CONSTRUED SECTION 70e OF THE NATIONAL BANKRUPTCY ACT BY REVERSING THE DECREE OF THE TRIAL COURT FOR MONEY, THEREBY DENYING TO THE TRUSTEE, PETITIONER HERE, THE ELECTION TO RECOVER VALUE IN A SUIT BROUGHT UNDER SAID SECTION; AND IN DENYING A MONEY DECREE FOR VALUE UNDER FACTS APPEARING IN THE RECORD WHICH MADE THAT THE ONLY RELIEF WHICH WAS POSSIBLE.

B. IN A FEDERAL EQUITY APPEAL, NO NEW EVIDENCE CAN BE RECEIVED (U. S. REV. STAT., SECTION 698; U. S. CODE TIT. 28, SECTION 863).

C. THERE IS NO JURISDICTION IN A FEDERAL COURT OF EQUITY IN A CONTROVERSY ARISING OUT OF BANKRUPTCY TO ADJUST THE PRIORITIES AND DISTRIBUTE THE PROCEEDS OF THE PROPERTY OF THE BANKRUPT ESTATE, THAT BEING THE EXCLUSIVE PROVINCE OF A COURT OF BANKRUPTCY UNDER NATIONAL BANKRUPTCY ACT, SECTIONS 2 (7), 47 (a), (2), and 70 (b), (c).

D. The Trustee is not precluded, in a suit on behalf of all creditors, from asserting that a transfer was fraudulent by the fact that one of the creditors took additional security which recited the existence of the transfer assailed as fraudulent.

E. Under the law of California, a corporation of that state is prohibited from acquiring its own issued shares except under circumstances none of which appear in this record (California Civil Code, Section 309, in force in 1926).

F. It was error for the Circuit Court of Appeals to assume jurisdiction over the 2499 shares of respondent Peter Barceloux Company's stock by reason of the mere intoduction of certain cancelled certificates in evidence.

G. The sale by the corporation of the stock acquired at a pledge sale held invalid constituted a conversion and therefore the money judgment was proper and should have been affirmed for that reason.

H. The decision of the Circuit Court of Appeals ignored and did not overcome the trial Court's finding that the pledge of April 27, 1926, was void as to creditors for want of immediate delivery and a continued change of possession as required by Section 3440 of the Civil Code of the State of California.

I. The trial Court's findings of fact should not be reversed on appeal when based upon the testimony of witnesses heard and observed by the

TRIAL JUDGE, AND ALSO BASED ON WRITTEN EVIDENCE CONSISTENT WITH HIS FINDINGS AND INCONSISTENT WITH CONTRARY FINDINGS.

A.

THE CIRCUIT COURT OF APPEALS ERRONEOUSLY CONSTRUED SECTION 70e OF THE NATIONAL BANKRUPTCY ACT BY REVERSING THE DECREE OF THE TRIAL COURT FOR MONEY, THEREBY DENYING TO THE TRUSTEE, PETITIONER HERE, THE ELECTION TO RECOVER VALUE IN A SUIT BROUGHT UNDER SAID SECTION; AND IN DENYING A MONEY DECREE FOR VALUE UNDER FACTS APPEARING IN THE RECORD WHICH MADE THAT THE ONLY RELIEF WHICH WAS POSSIBLE (SEE SPECIFICATION OF ERROR NO. 1, THIS BRIEF, PAGE 12, AND STATEMENT OF QUESTION INVOLVED NO. 1, PETITION FOR CERTIORARI PAGE 4).

This argument is in two parts denoted as "First" and "Second."

First.

The majority decision of the Circuit Court of Appeals (R. 475, 476, 481), as hereinafter more fully stated, was that the trustee has no right of election. The minority opinion was that such option existed (R. 497). The exact words of National Bankruptcy Act, Section 70e, in this particular, are:

> "The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication."

The present suit was brought to recover value and not property.

The Circuit Court of Appeals ruled in the majority opinion that where the "property is subject to the jurisdiction of the Court" a money decree cannot be given (R. 475, 476), concluding that (R. 480):

> "They are only entitled to judgment for the value of the property *in the event and for the reason that the property itself could not be subjected to their claims. The substitution of the value of the property for the property itself is not a right of the plaintiff unless and until it is determined that the property itself cannot be subjected to his claim,* * * *." (R. 480, 481. Italics ours.)

Again:

> *"The trustee in bankruptcy acting for the creditors has no right of election"* (R. 481. Italics ours).

It cannot be said that the Circuit Court of Appeals, in the majority opinion, admitted the right of election by the Trustee and denied that this was a proper case for it. The decision was that he "has no right of election" (R. 481, middle of page).

The logic and plain words of this holding are that the Trustee has no choice between value and property under Bankruptcy Act, Section 70e; that he must take property or nothing, when property is available, and can take value only after the Court has found that he could not have recovered property; there is no choice.

In so holding, the Circuit Court of Appeals in the majority opinion held contrary to an earlier and plain decision of the Ninth Circuit Court of Appeals (*Schainman v. Dean,* 24 Fed. (2d) 475, at page 476, *certiorari* denied, 278 U. S. 598). The majority opinion is also contrary to and overrules the contention of Judge Sawtelle in the dissenting opinion (R. 497) that

> "Section 70e of the Bankruptcy Act * * * gives the trustee the unrestricted election of whether he shall sue for the property or its value."

The Ninth Circuit Court of Appeals in earlier cases implicitly recognized the right to have a value decree in a suit brought by election on the equity side of the Court.

Brainard v. Cohn, 8 Fed. (2d) 13, 15 (C. C. A. Ninth);

Oliver v. Brennan (In re Wright Motor Company), 299 Fed. 106, 108 (C. C. A. Ninth).

As a matter of fact and information, as shown by the two letters from the counsel for respondent to the Clerk of the Circuit Court of Appeals, which were filed as a part of the record of such Court in this cause (R. 452, 454), the respondent's position on this point does not appear to have been fully and clearly developed until reargument was had in the Circuit Court of Appeals at the instance of that Court, upon which reargument the respondent (the appellant) offered to tender 2499 shares of the stock of respondent into Court for disposal. The contention of respondent (appellant) in this connection was in sub-

stance that the property itself would thus be made recoverable *in specie,* and that in such a situation no money recovery could under any circumstances be decreed. This contention appears to have been an outgrowth of respondent's theory on the appeal below that a court of equity acts specifically and therefore could not decree value, but must decree property or nothing.

Section 70e of the Bankruptcy Act has stood without amendment as it was enacted in 1898, except for the amendment of 1903, which fixed jurisdiction of the Courts, and is mentioned here only for the purpose of showing that such amendment is in no wise involved. The rights which are given by Bankruptcy Act, Section 70e, are two:

First, the right to avoid a transfer which any creditor might have avoided had bankruptcy not intervened.

Second, if the Trustee succeeds in avoiding the transfer, he has the right to recover either the property or its value.

Upon a proper construction of this section the rights of the Trustee depend upon the rights of creditors only for the purpose of avoiding the transfer; the right of recovering the property or value, either the one or the other, depends solely upon the Bankruptcy Act. Thus the Bankruptcy Act added to the creditors' right to avoid the transfer a new and distinct recovery which the creditors might not or would not have had if bankruptcy had not intervened and one of them had sued. Conversely, if it had been the intention of

Congress to give the Trustee only those rights of annulment and of recovery which a creditor might have had if bankruptcy had not intervened and he had sued, then the section would necessarily read somewhat as follows:

> That the Trustee may avoid any transfer by the bankrupt of his property and may recover the property so transferred or its value from the person to whom it was transferred, as any creditor of such bankrupt might have avoided it and recovered.

This paraphrase of the section would have the effect of making the Trustee in such a suit a representative *of that creditor alone* who might have sued, and no recovery would be possible other than such creditor could have had. The other creditors would necessarily in a suit under such a statute recover nothing, and this supposititious statute and construction would have been contrary to what has been recently decided by this Court in *Moore v. Bay,* 284 U. S. 4, that the Trustee represents all the creditors and recovers for all of them, the recovery to be distributed *pro rata* among them. Any construction, therefore, which would limit the recovery of the trustee to the rights of a single creditor under local law must necessarily be rejected.

The following may be stated as reasons why Section 70e must be construed as giving, first, a right to avoid, and, second, a right to recover for all creditors the property or its full value. The central purpose of the Bankruptcy Act is to gather into the proceedings in bankruptcy all the estate of the bankrupt, including

property fraudulently conveyed by him in fraud, delay or hindrance of his creditors. As expressed in Bankruptcy Act, Section 47 (a) (2), it is the duty of the Trustee to

> "* * * collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estate as expeditiously as is compatible with the best interests of the parties in interest."

In due course thereafter the money is to be distributed to creditors in dividends. The last quoted words from Section 47 (a) (2) were also in the Bankruptcy Act as first enacted in 1898, and, therefore, it is plain that the object of Section 70e was to give the Trustee a right to sue which would adequately enable him to perform the duties imposed by Section 47 (a) (2). To perform the duties so imposed, he is given the power by Section 70e to avoid any transfer which any creditor might have avoided if bankruptcy had not intervened. In legal effect, such an avoidance of the transfer would revest the property in the bankrupt who had fraudulently transferred it, and, if Section 70e had gone no further, the Trustee might then have been obliged to bring further suits at law or in equity to recover the property or its value, as the facts of the case would permit. However, in furtherance of his duty to reduce the estate to money and close up the estate as expeditiously as would be compatible with the best interests of the parties in interest, it was necessary for Congress to give the Trustee, in the suit to avoid the transfer (in order that complete relief might be had) the additional right of an abso-

lute election to recover the property or its value. This election is vested in the Trustee because, if a fraudulent transfer made more than four months before the adjudication in bankruptcy were merely avoided by a Court of equity doing nothing more, the title then revesting in the bankrupt, the Trustee might then proceed to reclaim and possess the property, if he chose. [Such a right of reclamation is in fact given as to transfers made within the four months' period by Section 67e]. Two actions would be required or might be required under such a construction to obtain possession of the property, and after such actions the Trustee would be obliged to sell the property or in some manner convert it into money for distribution, a most dilatory procedure that would cause creditors to lose by delay and expense, if not in other ways. Therefore, the plain purpose of Section 70e is to dispose of the suit expeditiously in one decree, culminating in whatever judgment would be proper and expedient to the prompt disposition of the estate and distribution of money.

We think the foregoing shows that the construction for which we contend is agreeable to the spirit of the Bankruptcy Act and the only construction which is proper under that spirit, but it is also agreeable to the pervading spirit and principles of equity. It would be contrary to the principles of equity to construe Section 70e in such wise that the decree must always be for surrender of the property, if available, but if not available, then only for its value at the date of the wrong. So to construe the statute would have the effect of leaving open to the wrongdoer, the fraud-

ulent transferee, the ability to withhold both the property and its value until the outcome of the judgment showed which would be most profitable for him to choose in satisfaction of the decree. Counsel know of no rule or precedent in an ordinary creditor's suit which gives the fraudulent transferee such an advantage or right to speculate in fluctuations at the expense of the creditors. In the eyes of equity, the injury is done to the creditors at the time the fraud upon them was committed, but the quantity of that injury measurable in money is determined by what the creditors might have realized, up to the amount of their debts, if the property had been available to satisfy those debts in due and regular course. If this be true, and counsel believe it to be elementary, then it must be still more obnoxious to the principles of equity that a fraudulent transferee could put the property out of his possession, render himself unable to return it, next obtain possession after he was sued, and then surrender it to avoid responsibility for its value. There is no known principle of equity which gives a wrongdoer an election to choose and dictate the least costly way out of his predicament.

It is not necessary to rest here. An analogy exists indicative of the proper construction.

There are two sections in the Bankruptcy Act which give a right to avoid a transfer, and coupled therewith, a right to recover the property or its value. First, Section 60b, which relates to unlawful preferences, gives that right; and, second, Section 70e, which relates to fraudulent conveyances, gives that right.

Although this Court has not decided just what the right of election is under Section 70e, it had that question before it, arising under Section 60b, in *National City Bank v. Hotchkiss*, 231 U. S. 50. At page 59 it appears that the suit was one in equity to recover *in specie* certain securities, which had been transferred by way of unlawful preference. After the suit was begun, the parties, by a stipulation, authorized the transferee to sell the securities and to hold the proceeds, subject to the outcome of the litigation. The securities were not sold and subsequently declined in value. When the case came to final decision, the Trustee claimed the right to have the value of the securities as of the time of the preferential transfer instead of the securities themselves, which he had sued for, contending that the statute gave him this right of election. This Court sustained the decision of the District Court that such right had been waived by suing for the specific securities and by stipulation that they might be sold. By this decision this Court recognized that an election had been made, and held that, having once been made, the Trustee must abide by it. It is true that this Court's decision in that case did not pointedly and specifically decide that the Trustee could elect to recover value instead of property, but that is the necessary implication of the decision. This Court held that the Trustee could not revoke his election or waive it and newly elect. In holding that the Trustee must stand by his election, this Court must have held that he had a right to elect. Moreover, in that case the right to elect was directly raised and was before the Court, as appears from

excerpts in the briefs filed in behalf of the Trustee in that case (see 58 L. Ed. U. S., page 119), since the Trustee there contended:

> "The statute gives the trustee the right to recover the value of the securities or the securities themselves, at his election.
>
> Collier, Bankr., 8th ed. 1910, page 675; re Phelps, 3 Am. Bankr. Rep. 396."

Counsel believe it fair to conclude that the right of election, which this Court in that case tacitly recognized to exist by denying that it could be recalled, was such right of election as was in that case contended for.

In *Collier on Bankruptcy,* 1925 Ed., page 1330, the corresponding matter is found in the following words (referring to Sec. 60):

> "Subdivision b provides the trustee may recover the 'property or its value.' Similar words were used in the law of 1867. The option of suing for the property or its value rests with the trustee. These words are doubtless merely expressive of the rule of law. In most cases, the value, *i. e.,* damages, is demanded."

The case of *In re Phelps,* 3 Am. Bankr. Rep. 396, an opinion by a referee contains language which counsel desire to quote hereafter and adopt, because of its pertinence. A motion was there made to instruct the Trustee to bring a suit to recover an unlawful preference. The referee, in stating one of the questions at issue, said, at page 399:

> "If such an action can be brought, should the trustee be permitted to sue for value or only for the goods?"

Thus was presented at the outset the contention which respondent (appellant below) made in the Circuit Court of Appeals.

It was contended before the referee (page 402):

> "* * * that the words 'he may recover property or its value,' found in section 70e, really mean that if the creditor has disposed of the goods, or cannot restore them, he can be sued for the value, but that if he has not or cannot, the suit can only be for the goods; (citing cases). * * * The natural meaning of the words is that the trustee may elect which he shall do."

This is precisely the contention which respondent makes in this case (see R. 91, Ground No. 7 of notice of motion to vacate and set aside interlocutory decree) and which was also specified in its assignment of errors (R. 107).

The referee in his opinion concluded (3 Am. Bankr. Rep. 403):

> "* * * an important principle is involved, and, much though I sympathize with the unfortunate condition in which the Fuller interests find themselves, I cannot consent to go on record as approving the doctrine that a creditor or class of creditors can attempt a fraud on other creditors and, after an adjudication in bankruptcy, come into Bankruptcy Court practically admitting the fraud, but offering to restore the property fraudulently transferred. Many cases might arise in which it would be vastly to the injury of the other creditors if such a proceeding were tolerated. In my own experience, a collusively

secured creditor has, in one case, broken into the store of the bankrupt, which was constructively *in custodia legis,* an adjudication having been made, but the first meeting not having been held, and forcibly removed the goods, including expensive fixtures, thus largely decreasing the value of the estate. While this was done after the adjudication and with knowledge of it, yet the same thing might be done collusively before adjudication. In neither case should such a creditor be allowed to restore only, but should be charged with some penalty for his acts. In short, the words of the statute are clear; the trustee can sue for goods or for value. A collusive transfer is not a crime, but it is a wrong on other creditors. The courts cannot punish; they should, if possible prevent such practices. At any rate, they should set their faces against the doctrines of repentance and absolution as applied to bankruptcy proceedings."

Second.

If this Court should conclude that the majority decision of the Circuit Court of Appeals was correct wherein it held that the Trustee has no right of election, nevertheless under Section 70e, property or value are made alternatives, and the one or the other may be recovered. Under the pleadings in this case and the evidence shown by the record, the Trustee in any view and by either construction correctly brought this suit within that statute. It appears by the record that the suit was brought for the recovery of value, alleging that the property was no longer in the possession of the respondent, which,

as a pledgee, sold its own shares, bought them in at its own pledge sale, thereafter sold them to George A. Barceloux (R. 25, 26), and twelve days after the answer was filed in this case, attempted to take those shares back by a retransfer from George A. Barceloux to itself (R. 322, 418, 419). Paragraph IX of the answer admits the transfer to George Barceloux and by a negative pregnant alleges that George Barceloux had at some time thereafter transferred the shares to some presumably bona fide holder for value, identity not disclosed. Plaintiff could rest on that without amending to plead and prove that the respondent had not only made it impossible to recover the specific shares from it, but had in legal effect, attempted to convert its rights from those of a special proprietor in pledge to that of a general and unlimited owner of the shares.

A situation very similar to the case at bar, except that it was a preference under Section 60b of the Bankruptcy Act, was presented in the case in equity of *Feilbach Co. v. Russell,* 233 Fed. 412 (Sixth C. C. A.), where, on pages 414 and 415, in discussing this, the Circuit Court of Appeals sustained a judgment for value under the following circumstances: The Feilbach Company, holding a mortgage which was an unlawful preference, assigned it to Peavey. Peavey foreclosed the mortgage as assignee thereof, and thus obtained possession of the mortgaged property. He was co-defendant with the Feilbach Company in the suit for value. He was thus a defendant in possession of the specific property which was the subject of the preference. The Sixth Circuit Court of Appeals said, on page 415:

> "He obtained possession of the mortgaged property and, through foreclosure proceedings, converted it to his own use. Upon the plainest principles of law, he became liable for its value when the mortgage was set aside."

This is a clear decision in a preference case and in equity that value may be awarded, notwithstanding that property could have been reclaimed in specie. The right to elect to recover value is affirmed by necessary implication.

Another and more recent case, also a preference case, in which value was decreed although the property was at the time in possession of the defendant, is *Irving Trust Company v. Siroty,* 60 Fed. (2d) 71 (Second C. C. A.). In that case, certain clothing had been repossessed by the defendant from the bankrupt by way of preference, and for the first time on appeal the defendant urged that because Section 60b allows the Trustee to recover the property or its value, the decree for value was wrong and should have been a decree for the property, because the property remained in the possession of defendant. The suit, as in the case at bar, was a suit for the value of the property and for an accounting. At the trial, though it appeared that the property was still in the defendant's possession, proof of value was received without objection. The Circuit Court of Appeals, characterizing the objection as an afterthought first presented in a reply brief, declined for that reason to consider the point on appeal, and sustained the value decree in so far as it applied to the specific property. It did not intimate, how-

ever, that if the question had seasonably been presented, any different result would have been reached.

In the case at bar, the objection was not made in the trial Court. On the hearing before the master to take evidence of value, counsel for the defendant (respondent here) stated that the question "is the value of the stock of the Peter Barceloux Company" (R. 77), thus admitting that such evidence was competent. An exception was taken to the master's report (R. 65), that the master "instead of following the directions of the interlocutory decree and finding the highest market value * * * has placed a value on each asset of the corporation," admitting again that value was in issue and evidence properly received. After the decree was entered, it was assigned for error (R. 107, 108), that the Court had no jurisdiction to enter the money judgment and that the same was beyond the jurisdiction of the Court, because the shares now in question were in the possession of the defendant and the only proper relief was to annul and cancel the transfer and to adjudge and decree the return of the stocks (Assignments First and Second). It thus appears that these assignments are not supported by any ruling evoked by an objection made at the trial.

At the trial of the case it appeared from the testimony of George A. Barceloux that not until twelve days after the answer was filed, to-wit, on May 11, 1930, were these shares retransferred by him to defendant Peter Barceloux Company (R. 419). There was nothing in the answer to show that defendant Peter Barceloux Company was in a position

to redeliver the shares which by its own admission had passed out of its ownership. Thus, it appears by the record that when the suit was brought and when issue was joined on the bill, the admitted facts as well as the proven facts show that a suit to recover the specific shares would have been abortive and fruitless, and that a suit for value was the only one which the Trustee could have brought with any hope of success. If the law made the election, then the Trustee in this suit has elected that which the law made for him. For this reason, if the Circuit Court of Appeals correctly held (which we do not concede) that Section 70e gives the Trustee no right of election, nevertheless, the judgment of the Circuit Court of Appeals was erroneous, because the decree of the trial Court is rightly founded upon the election made by the law.

It may be added, in explanation of the decision of the Circuit Court of Appeals, that strong reliance was placed by that Court (R. 479) upon *Dunphy v. Kleinschmidt,* 11 Wall. 610. Upon the supposed authority of that case, the Circuit Court of Appeals said (R. 480), that the plaintiffs "are only entitled to judgment for the value of the property in the event and for the reason that the property itself could not be subjected to their claims." It need only be said that *Dunphy v. Kleinschmidt* did not so decide. The reversal of the *Dunphy* case was made because the trial Court, in a suit begun in equity, did not continue to proceed as such, but reverted to a verdict of a jury for damages instead of going on to an accounting. It is not necessary to engage in

further discussion of this case; it suffices merely to cite *Mann v. Appel,* 31 Fed. 378, where, at page 383, the doctrine of *Dunphy v. Kleinschmidt* is explained in support of the right to bring and sustain a suit in equity for value where a legal remedy existed which might have proved less adequate.

B.

IN A FEDERAL EQUITY APPEAL, NO NEW EVIDENCE CAN BE RECEIVED (U. S. REV. STAT. SECTION 698; U. S. CODE TIT. 28, SECTION 863). (SEE SPECIFICATION OF ERROR NO. 2, THIS BRIEF, PAGE 13, AND STATEMENT OF QUESTION INVOLVED NO 2, PETITION FOR CERTIORARI, PAGE 5.)

The offer of respondent made in the Circuit Court of Appeals upon reargument to tender the 2499 shares of respondent's stock into Court for disposal, evidenced by the two letters set forth (R. 452 to 454), was not only an offer of new evidence on appeal, but was also tantamount to the pleading of new defenses on appeal. It is settled by the previous decisions of this Court that it is error for the Supreme Court to receive new evidence upon an appeal.

Blease v. Garlington, 92 U. S. 1, 4;
Roemer v. Simon, 91 U. S. 149, 150.

It is also settled that it is error for a Circuit Court of Appeals to receive new evidence.

Realty Acceptance Corp. v. Montgomery, 284 U. S. 547, 549.

The Second Circuit has also recently declared that affidavits not offered on trial could not be received upon appeal.

Youngs Rubber Co. v. C. I. Lee & Co., 45 Fed. (2d) 103 (Second C. C. A.).

The Ninth Circuit recently refused to consider a stipulation not submitted to the trial Court and not the basis of any ruling therein.

The Rethelulew, Official Number 227,860, 51 Fed. (2d) 646.

It will be noted that the letter set out (R. 453) contains an offer to file with the Circuit Court of Appeals a full and complete release executed by George A. Barceloux (not a party to the suit) disclaiming any interest in the stock in question. While no formal release appears to have been filed as there suggested, such release would have been evidence tending to show that the tender was good because the title to the shares was good, and the admissions or statements made in that letter have the same evidentiary tendency and must have been and were considered by the Circuit Court of Appeals in reaching the conclusion that the 2499 shares were within its jurisdiction, and subject to disposal by its judgment. In the majority opinion of the Circuit Court of Appeals in this case, it is said (R. 473) that "the company has tendered the stock to the clerk of the Court for such disposition as may be made thereof in equity and good conscience." There is nothing in the record to show that any tender whatever was made in the trial Court, and in fact none was made. To the contrary, the answer prays:

> "that the title of the Peter Barceloux Company in and to the securities in this answer herein mentioned, be declared to be good and valid;" (R. 28).

The record shows that there was no tender made in the trial Court, nor was there any evidence suf-

ficient in law to show that the trial Court had obtained jurisdiction over those shares. The record shows that the stock-book of Peter Barceloux Company was introduced in evidence by the plaintiff (R. 302), and such stock-book is plaintiff's exhibit No. 3 sent up herewith, in which Certificate No. 5 for 2499 shares issued to Henry Barceloux and thereafter cancelled, and Certificate No. 12 issued in lieu of No. 5 to the Peter Barceloux Company, as pledgee of the same shares, also thereafter cancelled, both appear attached to said stock-book. No certificate evidencing the ownership of said shares at the time of the trial was put in evidence by either party, and no evidence of the actual ownership of the 2499 shares at the time of trial appears in the record, except the certificate stubs found in said stock-book. The record, therefore, not only does not show any tender into the trial Court, but rebuts it. At another part of the record, it appears that at the time of the final decree in the District Court, a tender of all the shares pledged and sold *en masse* would have been impossible because some of them (certain bank, garage and insurance shares) included in the alleged pledge had been sold again by the defendant, after it received them by retransfer from George A. Barceloux, and those shares were no longer in defendant's possession or control (R. 180, 182, 189, 190). In denying rehearing, the Circuit Court of Appeals took cognizance of this fact, and credited the found value of these bank, garage and insurance shares upon the pledge debt (R. 507).

The statutory prohibition of the consideration of new evidence in an equity appeal in a federal Court

has existed continuously since the Act of 1803 (2 Stat. 244), which established the present mode of equity appeals. Until 1891, this limitation applied to the Supreme Court and to the Circuit Courts when sitting as courts of appeal, and by the Act of March 3, 1891, Ch. 517, Section 11 (26 Stat. 829), it was enacted:

> "And all provisions of law now in force regulating the methods and systems of review, through appeals and writs of error, shall regulate the methods and system of appeals and writs of error provided for in this act in respect of the circuit courts of appeal, * * *."

It is therefore settled that anything which amounts to the consideration of new evidence—facts not considered by the trial Court and not in the record—must not be considered in an equity appeal for the purpose of arriving at a different decree upon the merits from that which was given by the trial Court.

It is pertinent to consider whether a tender is new evidence or a new pleading of defense under such circumstances as surrounded its making in this case. If the tender was intended as a defense to the right to a money decree, then under New Equity Rules 29 and 30, it should have been made in the answer. The answer quite plainly excludes any such construction, for it prays (R. 28, paragraph III):

> "That the title of the Peter Barceloux Company, of, in and to the securities herein held by it, and that the title of the [23] Peter Barceloux Company in and to the securities in this answer herein mentioned, be declared to be good and valid; and that it have its costs herein."

To make a tender in the Appellate Court was tantamount to a material amendment of the answer, and as already said, a release or any admission or showing of title in the defendant made in that connection was merely irrelevant evidence tending to show that the tendered title was good.

The result of entertaining the tender and acting upon it, by giving the directions contained in the decision of the Appellate Court (R. 482, 483), was to direct such a decree as the trial Court itself could not have made. That, under the decisions of this Court, is error.

Lane v. Pueblo of Santa Rosa, 249 U. S. 110, 114;

Realty Acceptance Corp. v. Montgomery, 284 U. S. 547, 551.

Candor requires that it be mentioned that the Circuit Court of Appeals (R. 482) speaks of the attempted retransfer of the tendered shares by George A. Barceloux to the respondent (defendant below) as restoring the "*status quo.*" It seems moderate to say that no tender made for the first time on appeal could put the parties back into the *status quo* of the day when issue was joined, or even of the trial day. On the latter day the record of pleadings and proofs closes finally. Who can say what alteration of the *status quo* occurred between then and the time of submission of the cause on appeal? All intervening facts are purely speculative in the Appellate Court.

While no federal precedent has been discovered in which there was an attempt upon appeal to make a

tender which was not made upon the trial, yet respectable authority may be found condemning that practice. On the precise point in Massachusetts, it was held that tender is a matter to be pleaded or made below, and if not then made, cannot be pleaded on appeal.

> *Grover v. Smith,* 165 Mass. 132, per Holmes, J., on authority of *Brickett v. Wallace,* 98 Mass. 528.

Thus, to summarize this branch of the argument, the action of the Circuit Court of Appeals in receiving and considering the tender not only violated the statutory rule against the consideration of new evidence, but also departed from settled principles of appellate review, in that the Circuit Court of Appeals attempted to do more than correct the errors of the trial Court. While a federal equity appeal retries the case *de novo,* it does so only to the extent of the case as appearing by the record.

Mr. Chief Justice Taft, in *Keller v. Potomac Electric Power Company,* 261 U. S. 428, 444, describes the function of an equity appeal in the following language:

> "In that procedure, an appeal brings up the whole record and the Appellate Court is authorized to review the evidence and make such order or decree as the court of first instance ought to have made, giving proper weight to the findings on disputed issues of fact which should be accorded to a tribunal which heard the witnesses."
>
> See, also, *U. S. Rev. Stat.,* Sections 698, 1011, 1012 (U. S. Code Tit. 28, Sections 863, 879, 880 (Supp.)).

This, it is settled that the power to reverse is and must be based upon the commission of an error by the trial Court, as shown by the record of the equity appeal. A reversal on extrinsic facts is necessarily forbidden, and while counsel believe and urge that the Ninth Circuit Court of Appeals in this case did reverse on extrinsic matters and thereby departed from firmly settled principles of appellate review, in a way which is believed to set up a dangerous precedent, this contention is made with all due respect to the Ninth Circuit Court of Appeals, the judges of which certainly have every wish to refrain from creating dangerous precedents. The supervisory powers of this Court exist, however, to enable it to resist the beginnings of bad practices and the establishment of bad precedents, and we ask that this power be now exercised.

C.

THERE IS NO JURISDICTION IN A FEDERAL COURT OF EQUITY IN A CONTROVERSY ARISING OUT OF BANKRUPTCY TO ADJUST THE PRIORITIES AND DISTRIBUTE THE PROCEEDS OF THE PROPERTY OF THE BANKRUPT ESTATE, THAT BEING THE EXCLUSIVE PROVINCE OF A COURT OF BANKRUPTCY UNDER NATIONAL BANKRUPTCY ACT, SECTIONS 2 (7), 47 (a), (2), AND 70 (b), (c). (SEE SPECIFICATION OF ERROR NO. 3, THIS BRIEF, PAGE 13, AND STATEMENT OF QUESTION INVOLVED NO. 3, PETITION FOR CERTIORARI, PAGE 5.)

The Circuit Court of Appeals in its opinion reverses and remands the cause to the trial Court, "to fix the time, place and terms of the sale of said stock, and to direct the application of the proceeds of the

sale in accordance herewith" (R. 483). This has reference to that part of the opinion immediately preceding, in which the Circuit Court of Appeals holds that the stock should be resold under the pledge, subject to,

> "an application of the proceeds to the claims of the Barceloux Company aggregating $33,184.41. * * * If all the stock pledged to the Peter Barceloux Company sells for more than the amount due to that company as herein determined, the surplus shall be paid to the trustee to be applied to the claim of Freeman, as alleged in the complaint or bill, herein, and if there be any surplus over and above the claims of the Peter Barceloux Company and of Freeman, the balance should be applied to the claims of the general creditors" (R. 482, 483).

This direction casts upon the trial Court in equity the exclusive duty of the Trustee to collect, sell and reduce to money the property of the estate for which he is Trustee, all of which must be done under direction and approval of the Bankruptcy Court (Bankruptcy Act, Sections 47 (a) (2) and 70 (b)). The Trustee must make the conveyance (Bankruptcy Act, Section 70 (c)). Exclusive jurisdiction is specifically given to the Court of Bankruptcy by Bankruptcy Act, Section 2 (7).

Freeman was not a party to the suit, having been dismissed therefrom before the trial (R. 29), and thus no claim of his remained involved in this suit.

This Court has decided that how the fruits of the litigation shall be distributed is for the Bankruptcy

Court in which the proceeding is pending to determine.

Globe Bank & Trust Co. v. Martin, 236 U. S. 288, 304.

In *Isaacs v. Hobbs Tie & Timber Company,* 282 U. S. 734, at 738, speaking of the adjustment of the priorities of conflicting claimants asserting liens existing at the time of the commencement of the bankruptcy proceeding, this Court has said:

> "* * * it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation. * * * The exercise of this function necessarily forbids interference with it by foreclosure proceedings in other courts, which save for the bankruptcy proceeding would be competent to that end. * * *
>
> The jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate and the preservation of the rights of both secured and unsecured creditors. * * *
>
> Indeed, a court of bankruptcy itself is powerless to surrender its control of the administration of the estate."

The directions given by the Circuit Court of Appeals are in conflict with the principle there laid down and with the statute.

The foregoing need not be further elaborated, except to point out that the Bankruptcy Court and its officers might be seriously embarrassed in adjusting the priorities among creditors if this case culminated in such a decree as the Circuit Court of Appeals directed the District Court to make.

D.

THE TRUSTEE IS NOT PRECLUDED, IN A SUIT ON BEHALF OF ALL CREDITORS, FROM ASSERTING THAT A TRANSFER WAS FRAUDULENT BY THE FACT THAT ONE OF THE CREDITORS TOOK ADDITIONAL SECURITY WHICH RECITED THE EXISTENCE OF THE TRANSFER ASSAILED AS FRAUDULENT. (SEE SPECIFICATION OF ERROR NO. 4, THIS BRIEF, PAGE 13, AND THE STATEMENT OF QUESTION INVOLVED NO 4, PETITION FOR CERTIORARI PAGE 5.)

In the case at bar, the majority of the Circuit Court of Appeals held that creditor Freeman was estopped to assert fraud in the pledge herein assailed of the Peter Barceloux Company shares, because Freeman had taken an assignment or pledge of the same shares reciting the existence of a prior pledge of the shares to the Peter Barceloux Company itself. The Circuit Court of Appeals held that since the pledge agreement to Freeman, dated June 30, 1926, recited that it was subject to a prior pledge to the Barceloux Company, Freeman is estopped from attacking the validity of the prior pledge or from asserting that it was made to defraud creditors (R. 466), and that since the complaint failed to allege in clear terms that there were other creditors than Freeman at the time of the alleged fraudulent transaction, and since the proof at the trial failed to show the existence of other creditors [the opinion infers their existence, R. 472], or that they were defrauded thereby, there was no justification for a decision in favor of the Trustee on appeal based upon the rights of other creditors (R. 472).

The majority opinion containing a discussion of the estoppel doctrine (R. 466) is followed (R. 470) by a statement that the question of whether there was any

valid delivery of the pledge "might affect other creditors, but as to Freeman was immaterial because he accepted and ratified the later transaction (1926), pledging the stock to the company, believing, as he says, that there was ample equity to secure his claim." This is followed (R. 472) by a statement that:

> "So far as the right of the trustee in bankruptcy is predicated upon the right of Freeman to question the pledge to the company it cannot be sustained for he cannot complain of the prior pledge to which he assented."

Thus, it appears that the estoppel doctrine was introduced by the Circuit Court of Appeals in such a way as to confess that there was fraud as against Freeman, but to say he waived it and ratified the transaction, and in such a way as to concede that there were other creditors who may have been defrauded but to deny the right of the Trustee to rely on the fraud as to them by reason of the estoppel found against Freeman. Parenthetically, it may be observed that these concessions by the Circuit Court of Appeals that there was fraud and a subsequent ratification go far to destroy for inconsistency any finding by the Circuit Court of Appeals that the pledges were fair and free from fraud; but that will be argued in another portion of this brief (see *infra*, page 62). The opinion of the Circuit Court of Appeals applying the estoppel doctrine is erroneous in several particulars, in this:

(a) The Trustee is not precluded from asserting fraud unless all of the creditors, then existing and who might have asserted it, are estopped.

(b) This is not a suit by Freeman through the Trustee to enforce his junior pledge, and in such a suit only would he be estopped by such a recital.

In support of the first reason herein designated as (a), we submit that the Court erred in finding that Freeman was the only creditor upon whom the Trustee petitioner predicated his suit. The bill of complaint alleged that the bankrupt and the transferee consummated the transaction with intent to hinder, delay and defraud all non-kindred creditors (R. 5, 6, 8, 9 and 10), and that there existed at the times in question many unsecured creditors of said bankrupt (see Paragraph VII of the Bill of Complaint, R. 8). It is not necessary that the bill of complaint set forth the names of and the amount due to each of the creditors then existing, as the Circuit Court of Appeals holds, but a general allegation that there were creditors is sufficient.

See:

Collier on Bankruptcy, 1925 Ed., page 1782;
Keller v. Fowler Bros. & Cox, 148 Tenn. 571;
Dodd v. Raines, 1 Fed. (2d) 658 to 660; and
Flanders v. Coleman, 250 U. S. 223, 229.

The proof supported the pleading in this: that the bankrupt testified that at the time of the transfers he was indebted to fourteen unsecured creditors to whom he owed the total sum of $28,537.97, exclusive of the claims of Freeman, as administrator, and the Barceloux Company (R. 357-361). He was also indebted to secured non-kindred creditors other than Freeman in the total of $54,649.68 (R. 360, 389). His testimony was corroborated (R. 294) by the introduc-

tion as exhibits of the verified proofs of claims filed in the bankruptcy proceeding, which showed total unsecured claims in excess of $40,000.00 owing to parties other than Freeman, as administrator, and the Barceloux Company at the time of the various transactions (Plaintiff's Exhibit No. 1, R. 294). The trial Court found that there "were many [creditors] and represented by plaintiff herein" (R. 34). All creditors then existing were defrauded thereby, as shown by the fact that the bankrupt transferred all of his properties to the respondent herein and members of his family, and when adjudicated he had no properties remaining from which these non-kindred creditors could satisfy their demands (R. 33). Under local law, intent to defeat any creditor renders the transfer void as to all who were then his creditors (see Section 3439, Civil Code of the State of California, and also Section 3440 of said Code).*

The decision of the Circuit Court of Appeals deprives the Trustee (an officer of the Court) of the right of representing all creditors granted to him by Section 70e of the National Bankruptcy Act and places a construction upon said section in direct conflict with the decision of this Court, rendered since the trial of the case at bar, in *Moore v. Bay,* 284 U. S. 4.

In support of the second ground designated above as (b), we submit:

This is not an action to enforce Freeman's pledge, and the Trustee in Bankruptcy in the case at bar did

*See sections in full in appendix.

not represent Freeman as a pledgee or under his said pledge agreement. It is only the rights of the general unsecured crditors that passed to the Trustee under Section 70e of the National Bankruptcy Act, and therefore the Trustee represented Freeman as to that part of his claim against the bankrupt which remained unsecured, as shown by his proof of debt filed in the bankruptcy proceeding (see Plaintiff's Exhibit No. 1).

Further, the cases upon which the Circuit Court of Appeals relies as the basis for its holding upon estoppel do not warrant the construction given them. They were all suits to foreclose second mortgages which contained recitals that they were such and subject to prior mortgages. Where a party to such a second mortgage seeks relief upon his right as a common creditor independent of his contract of mortgage, the principles therein announced are not applicable.

Old National Bank v. Heckman, 148 Ind. 490, 507;

Jones on Mortgages, Eighth Edition, Volume 2, Section 912, page 256.

It is patent that Freeman's admission of the existence of a prior pledge was not an admission that it was valid, even had there been reliance and change of position in consequence which there was not. Besides, Freeman is an administrator who could not make such a binding admission or become estopped thereby.

E.

UNDER THE LAW OF CALIFORNIA, A CORPORATION OF THAT STATE IS PROHIBITED FROM ACQUIRING ITS OWN ISSUED SHARES EXCEPT UNDER CIRCUMSTANCES NONE OF WHICH APPEAR IN THIS RECORD (CALIFORNIA CIVIL CODE, SECTION 309, IN FORCE IN 1926). (SEE SPECIFICATION OF ERROR NO. 5, THIS BRIEF, PAGE 13, AND STATEMENT OF QUESTION INVOLVED NO 5, PETITION FOR CERTIORARI, PAGE 6.)

The Circuit Court of Appeals held that the defendant (respondent herein) acquired legal title to the 2499 shares of its own stock by a transfer from George A. Barceloux, who had purchased these shares from it after it had bought them in at the alleged pledge sale (R. 481), and that the retransfer of the stock of the corporation to itself merely restored the *status quo* and was in "no sense a purchase by the corporation of its stock in violation of the statutory rule" (R. 482). The law in the State of California at the time in question and at all times since has forbidden a corporation to repurchase its own stock except under specified conditions, and the transaction shown in this record is not one of them (see Section 309 of the Civil Code of the State of California prior to 1931; thereafter Section 342 of the Civil Code of the State of California*).

The Circuit Court of Appeals relies in support of the above holding on *Ralston v. Bank of California,* 112 Cal. 208 (R. 482). The construction thus given is in direct conflict with later and ruling decisions of the State of California. See *Stevens v. Boyes Hot*

*The above Civil Code sections are set out in full in the appendix.

Springs Company, 113 Cal. App. 479, 482, in which a hearing in the Supreme Court of California was denied on June 11, 1931, and which was thus made the ruling decision on California law in this regard. See, also, *Wagg v. Toler,* 80 Cal. App. 501, 510, prior thereto.

In *Stewart v. Stewart Hotel Company,* 33 Cal. App. 167, at 182 (a rehearing was denied by the Supreme Court of California), the highest Courts of California have held that the liability of a stockholder secured by his stock is an asset of the corporation and if the stockholder is solvent and able to pay, the corporation would have no more right to exchange that asset for his stock than to buy the stock outright.

Since the record does not show that George A. Barceloux was insolvent, the corporation's attempt to repurchase said stock was, under local law, as stated in *Stevens v. Boyes Hot Springs Co.,* 113 Cal. App. 479, 482, both *ultra vires* and *malum prohibitum,* and hence, utterly void and incapable of estoppel. The direction of the Circuit Court of Appeals being based upon the theory that title was reinvested by a transfer which the courts of California hold void, the appellee's (petitioner herein) only available remedy is a money decree based on value, and the tender elsewhere discussed in this brief is ineffectual.

When George A. Barceloux, on May 11, 1928, by agreement turned back the 2499 shares of the Peter Barceloux Company stock to that corporation, and the bank, garage and insurance shares which he had purchased from that corporation, after it had bought

all of them in, *en masse,* at pledge sale, that was (as far as the 2499 shares were concerned) a withdrawal of the capital or assets of the Peter Barceloux Company, because George Barceloux testified, and it is uncontradicted, that "the note was handed to me and they retained the stock and I don't know whether I destroyed the note," etc. (R. 419). This note was an asset of the corporation, and for that reason the transaction fell within the condemnation of California Civil Code, Section 309, as it then stood. The Ninth Circuit Court of Appeals has also voiced its condemnation of transactions tending to withdraw capital from a corporation in violation of Section 309 of the California Civil Code. See:

Oliver v. Brennan (in re Wright Motor Company), 299 Fed. 106, 108.

It is patent that the same reasoning found in the above case applies and condemns the transaction, whether the corporation be the bankrupt, as it was in the case just cited, or a fraudulent transferee of the bankrupt, as in the case at bar. The Ninth Circuit Court of Appeals having correctly followed the local law in this particular, in *Oliver v. Brennan,* supra, should have followed it in the case at bar.

Had the Circuit Court of Appeals done so, there could be no claim or valid contention that the 2499 shares of respondent's stock was in Court and subject to disposal by decree in this case. The money decree must have stood, fraud and value having been found by the trial Court.

F.

IT WAS ERROR FOR THE CIRCUIT COURT OF APPEALS TO ASSUME JURISDICTION OVER THE 2499 SHARES OF RESPONDENT PETER BARCELOUX COMPANY'S STOCK BY REASON OF THE MERE INTRODUCTION OF CERTAIN CANCELLED CERTIFICATES IN EVIDENCE. (SEE SPECIFICATION OF ERROR, NO. 6, THIS BRIEF, PAGE 14, AND SEE STATEMENT OF QUESTION NO. 2, PETITION FOR CERTIORARI, PAGE 5.)

The specification of error to which this argument corresponds is an involved part of the question argued herein as Point B, supra, p. 33. As appears in the majority opinion of the Circuit Court of Appeals, the majority regarded the 2499 shares in question as having revested in the corporation by the retransfer from George A. Barceloux to the corporation (R. 474). The Court says:

> "That stock was accepted by the corporation and the note given as the purchase price thereof was cancelled. The stock certificate was offered in evidence and deposited with the Court. The testimony showed that it [stock certificate?] had been transferred to the corporation, and all the other stock sold at the pledgor's sale was also returned to the corporation."

The Circuit Court of Appeals (majority opinion) is in error in stating that the stock certificate was offered in evidence and deposited with the Court. The record shows that Certificate No. 5 of Peter Barceloux Company, originally issued to Henry J. Barceloux, cancelled and attached to the stub in the stock book, was in evidence, and Certificate No. 12, reissued by the Peter Barceloux Company to itself as pledgee,

and also subsequently cancelled and attached to the stub in the stock book, was in evidence (R. 302, Plaintiff's Exhibit No. 3, the stock book). This exhibit was placed in evidence by plaintiff (petitioner here) as part of his proof of fraud in the pledges. Certificates No. 5 and No. 12 appear on the face of them to have been cancelled. The stock book (R. 302, Plaintiff's Exhibit No. 3) shows that other certificates have been issued in lieu of Certificate No. 12 and are outstanding. These outstanding certificates were not introduced in evidence. The record contains no evidence who owned or held them during all the intervening time between August 16, 1926, soon after which Peter Barceloux Company sold these shares to George A. Barceloux (admitted by answer, paragraph IX, R. 26), and May 11, 1930, on which day the corporation took them back from George A. Barceloux (R. 419). The certificate held by George A. Barceloux during the interval, being transferable by endorsement, it cannot be presumed on this record who now owns the shares, and it thus appears that there is no predicate in the record and the proofs therein for any claim that the shares, much less the certificate evidencing them, have been tendered into the Circuit Court of Appeals or into the District Court.

It has long been the law of California that it is the shares of stock in a corporation which constitute property belonging to the shareholder, and that such property is not a property of a possessory nature but an intangible property.

Payne v. Elliot, 54 Cal. 339, 340.

This property in the shares is "usually evidenced by certificates of stock."

Burke v. Badlam, 57 Cal. 594, middle of page 601.

These certificates are not the shares, but evidence of them, so that the courts of California have power to determine and adjudge the ownership of the shares to be in some other person than the possessor of the certificates, as was done in *Jean v. Jean,* 207 Cal. 115, 120, 122. (This also was a family corporation in which the family interests were evidenced by shares in a corporation formed to hold the family property, and the parties to the case were litigating members of the family.)

Hence it cannot be assumed upon the record in this case what may be the rights of the various members of the Barceloux family among themselves with respect to the 2499 shares which originally were owned by Henry J. Barceloux; and it cannot be contended that the full question of ownership in those shares has been subjected to the jurisdiction of the Circuit Court of Appeals in this case; the record shows that there are no members of the Barceloux family who are made individual parties to this suit.

G.

THE SALE BY THE CORPORATION OF THE STOCK ACQUIRED AT A PLEDGE SALE HELD INVALID CONSTITUTED A CONVERSION AND THEREFORE THE MONEY JUDGMENT WAS PROPER AND SHOULD HAVE BEEN AFFIRMED FOR THAT REASON. (SEE SPECIFICATION OF ERROR NO. 7, THIS BRIEF, PAGE 14, AND STATEMENT OF QUESTION INVOLVED NO 6, PETITION FOR CERTIORARI, PAGE 6.)

Under the decision of the Circuit Court of Appeals that the Peter Barceloux Company's sale under the pledge was invalid, it follows that such corporation continued to hold those shares under the pledge and that it converted them to its own use when, a few days later, it sold an unrestricted ownership in those shares to George A. Barceloux. For this reason the money decree of the District Court was right and should be affirmed.

That part of the majority opinion of the Circuit Court of Appeals which concludes that the pledge sale by the Peter Barceloux Company was invalid (R. 473) goes on to say that the conduct of the corporation (respondent here) in making that sale without notice as agreed "does not appeal to the conscience of the chancellor and if consistent with the applicable principles of law the Trustee should be relieved from the forfeiture of the equity in the stock so sold." This tacitly recognizes that the Trustee in bankruptcy of Henry J. Barceloux had an equity in the shares of stock while the pledge continued, from the forfeiture of which equity by an invalid pledge sale the Trustee should be relieved. The equity which the Trustee had in that situation was the right of Henry Joseph Barceloux to have redeemed those shares from a pledge which continued to subsist.

While a pledge subsists as between the pledgor and the pledgee, the real ownership of the pledge remains in the pledgor under the law of California.

People v. Robinson, 107 Cal. App. 211, bottom of page 220.

Thus it is that if the pledge sale was invalid the general property in the pledged shares vested by force of Bankruptcy Act, Section 70 (a) (5) in the Trustee (plaintiff below), and conversion accomplished by selling to George A. Barceloux also vested in the Trustee a right of action under said Section 70 (a) (6); and since this suit was rightly begun in equity upon the facts pleaded in the bill and admitted by the answer, the supposed conversion developing for the first time as a technical legal consequence of the holding of the Circuit Court of Appeals supports the judgment of the trial Court, which was for the value of the shares so sold and transferred. Had the question thus arisen incidentally in a case rightly begun in equity, the trial Court would have decided the incidental legal question according to New Equity Rule 23; and, so decided, the Circuit Court of Appeals should have affirmed agreeable to principles laid down in:

Twist v. Prairie Oil & Gas Co., 274 U. S. 684;
American Mills Co. v. American Surety Co., 260 U. S. 360.

The Circuit Court of Appeals states in the majority opinion (R. 473) that:

> "There is a divergence of views among the members of the court as to the consequences which should flow from the manner and method of the sale."

It is believed that the foregoing citations of California ~~statutes~~ decisions and of the Bankruptcy Act clearly show what consequences should flow from the manner and method of the sale. At any rate, the consequences of an invalid pledge sale, and the subsequent exercise of acts of absolute ownership by the pledgee, would under the decisions of the courts of California constitute a repudiation of the pledge, if there was one.

Lowe v. Ozmun, 3 Cal. App. 387, 394 (identical facts);
Bell v. Bank of California, 153 Cal. 234, 238;
Henning v. Akin, 91 Cal. App. 246, 255, 256.

The general law of pledges is recognized by Federal courts to be the same.

Dibert v. Wernicke, 214 Fed. 672, 682, 683 (C. C. A. 6th, identical facts);
Feilbach Co. v. Russell, 233 Fed. 412, 415 (C. C. A. 6th).

The attempted retransfer of the shares by George Barceloux to the defendant corporation did not cure the conversion or absolve the corporation from liability for the money value of the converted property.

Henning v. Akin, 91 Cal. App. 246, at 255.

The value at that time having been found by the Court below (R. 61), the record thus afforded everything necessary to affirm the judgment instead of reversing it, and it should have been affirmed.

Johnson v. Peoples State Bank, 22 Fed. (2d) 211, at 213.

Furthermore, with respect to certain shares of stock other than the 2499 shares and covered by the same pledge, the defendant corporation, after receiving them back from George A. Barceloux, sold them again to others (R. 182, 189, 190) and never regained possession, and the decision of the Circuit Court of Appeals upon rehearing recognized the binding effect of that sale by allowing a credit equal to the found value at the time of the conversion (R. 507).

H.

THE DECISION OF THE CIRCUIT COURT OF APPEALS IGNORED AND DID NOT OVERCOME THE TRIAL COURT'S FINDING THAT THE PLEDGE OF APRIL 27, 1926, WAS VOID AS TO CREDITORS FOR WANT OF IMMEDIATE DELIVERY AND A CONTINUED CHANGE OF POSSESSION AS REQUIRED BY SECTION 3440 OF THE CIVIL CODE OF THE STATE OF CALIFORNIA. (SEE SPECIFICATION OF ERROR, NO. 8, THIS BRIEF, p. 14, AND SEE STATEMENT OF QUESTION NO. 7, PETITION FOR CERTIORARI, p. 6.)

The trial Court found that the pledge evidenced by the written pledge agreement dated April 27, 1926, was void under Section 3440* of the Civil Code of the State of California for the want of delivery and the continuous change of possession of the certificate representing said shares (R. 34). This question was not passed upon by the Circuit Court of Appeals. In the majority opinion (R. 470) it is stated that the opinion of the trial Court indicates that it was of the opinion that the antecedent pledge was void for the lack of delivery by the bankrupt to the company.

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*See section in full in appendix.

The "antecedent pledge" referred to the contention of the respondent that Henry had pledged his said certificate covering his 2499 shares of the respondent company's stock to the company by an oral agreement with his father in 1917 or 1918, which is claimed to have been renewed by the written pledge agreement dated April 27, 1926. This contention was raised at the trial for the purpose of defeating the legal effect of the lack of delivery under the written pledge agreement dated April 27, 1926. The Circuit Court of Appeals misconstrued the trial Court's findings in this regard, in that the trial Court found that the pledge of the 2499 shares to respondent "was void for that the pledged certificate and *any writing of pledge* until said time were in his possession" (see bottom of R. 33 and top of R. 34), and the record shows without conflict that the only "writing of pledge" that respondent ever had was the agreement dated April 27, 1926 (R. 337, 350). Such finding necessarily carries the implication that the trial Court disbelieved Henry's testimony as to the existence of a "preexisting pledge."

In support of its said contention the respondent relies solely upon the testimony of Henry Barceloux, which testimony is completely impeached by the documentary proof, as is shown by the following.

Henry testified that he gave the respondent his stock as collateral to secure his then existing indebtedness and all future advances under an oral agreement with his father, who was then manager of the corporation, and that this was done in 1917 or 1918 (R. 346, 348). He was not certain whether he de-

livered the certificate to his father or to his brother-in-law, who was then acting as assistant secretary, but he was emphatic that the oral understanding was had only with his father (R. 346, 348). The security was given to secure moneys that he had then borrowed on open account, which was later evidenced by a promissory note in the sum of $24,000.00, which the bankrupt emphatically stated was accumulated between the years 1917 and 1918 (R. 348). The bankrupt's father died in December, 1918 (R. 378). The said testimony is entirely dispelled by the documentary proof introduced in evidence. The ledger sheet of the respondent entitled "H. J. Barceloux," showing the open account withdrawals of the bankrupt, which was introduced in evidence as Defendant's Exhibit No. 7 (R. 326), shows that in the years 1920, 1921 and 1922, the corporation was the debtor of H. J. Barceloux, owing him for salary the following amounts in the respective years: $230.00, $1035.00, and $460.00, or, on December 31, 1922, the total sum of $1725.00. Further, a debit balance in favor of the corporation does not appear in said account until June 28, 1923. The bankrupt continued his borrowings during the years 1924 and 1925, and in the latter year the promissory note for the sum of $24,000.00, evidencing all of said borrowings, was taken. Therefore, if he pledged his stock by an oral agreement with his father to secure these advances, it was not done in 1917 or 1918, and could not have been done until there was a debit balance, to-wit, in 1923, and at that time his father was dead. This stamps his testimony as false.

Further, there were no promissory notes shown by the books of the respondent company owing by the bankrupt to the company until April 27, 1922 (misstated in Record as February 27, 1922, R. 327), which is the date of the note in the sum of $2,000.00. George Barceloux admitted that the corporation had no security in 1919 (R. 298), and security was first given in "1921 or 1922, somewheres around there" (R. 298). The bankrupt was emphatic that the only pledge that he gave prior to the pledge dated April 27, 1926, was by agreement with his father to secure debts which were finally evidenced by the $24,000.00 note, and therefore there could have been no pledge executed in 1921.

Since the said entries on the respondent's ledger sheets were made in due course of business and a long time prior to and free from this sequence of events that placed all of the properties of the bankrupt beyond the reach of his non-kindred creditors, said documentary proof conclusively established the truth and stamped the testimony of the bankrupt as false, and further emphasized the rashness and improbability of the bankrupt's testimony.

Further, in the event that any weight is given to the bankrupt's testimony, then and in that event the documentary proof shows that such indebtednesses so secured were paid off prior to 1923, and the pledge, if any, so terminated.

Since the majority opinion of the Circuit Court of Appeals stated that the pledge of April 27, 1926, was, as to Freeman, a preference (R. 467), it necessarily found that no pledge existed prior thereto, for if such

prior pledge then existed, the latter transaction would not have been a preference, but a renewal of such purported preexisting pledge.

Having demonstrated that there was no preexisting pledge and Henry having the possession of the certificate representing his shares in the respondent corporation at the time of the purported execution of the pledge agreement dated April 27, 1926, no valid pledge could then have been created except by delivery of his certificate to the pledgee. See:

McFall v. Buckeye etc. Assn., 122 Cal. 468, 470;

Harvey v. Stowe, 219 Fed. 17, 22 (C. C. A. 9th);

Casey v. Cavaroc, 96 U. S. 467, 486.

Since Henry brought with him to said meeting his said certificate, and after the meeting retained the same in his possession, together with the purported written pledge agreement, until July 28, 1926, said purported pledge agreement was conclusively presumed to be fraudulent and void as to all those who were his creditors while he so remained in possession, of whom the trial Court found there were many (Section 3440,* Civil Code of the State of California).

The provisions of Section 2988 of the Civil Code of the State of California provide that the lien of a pledge is dependent on possession, and no pledge is valid until the property transferred is delivered to the pledgee, or to a pledge holder.

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*See section set forth in full in appendix.

Section 2993* of the Civil Code of the State of California provides that the pledge holder must be some third party, and that the pledgor cannot act as a pledge holder.

Further, the provisions of Section 3440* of the Civil Code of the State of California are applicable to a pledge of corporate stock, and it provides that for such pledge to be valid as against creditors of the pledgor, it must be accompanied by immediate delivery of the certificate and followed by an actual and a continued change of possession thereof.

See:

McFall v. Buckeye etc. Assn., 122 Cal. 468, 470,

and

Harvey v. Stowe, 219 Fed. 17, 22, a decision of the Ninth Circuit Court of Appeals based upon California statutes and law.

This Court, in construing like statutes of other states, has also so held.

See:

Casey v. Cavaroc, 96 U. S. 467, 486;
Christian v. Atlantic & N. C. R. R. Co., 133 U. S. 233, 241.

If the decision of the Circuit Court of Appeals be construed to reverse the finding of the trial Court in this regard, it is in direct conflict with *Casey v. Cavaroc,* 96 U. S. 467, in which case (like the case at bar) the president of the pledgor endeavored to consummate a pledge by the delivery of the securities to

*See sections set forth in full in appendix.

himself, as agent of the pledgee, and this Court held that such pledge was invalid as to creditors for the want of legal delivery.

I.

THE TRIAL COURT'S FINDINGS OF FACT SHOULD NOT BE REVERSED ON APPEAL WHEN BASED UPON THE TESTIMONY OF WITNESSES HEARD AND OBSERVED BY THE TRIAL JUDGE, AND ALSO BASED ON WRITTEN EVIDENCE CONSISTENT WITH HIS FINDINGS AND INCONSISTENT WITH CONTRARY FINDINGS. (SEE SPECIFICATION OF ERROR NO, 9, THIS BRIEF, PAGE 15, AND SEE STATEMENT OF QUESTION NO. 8, PETITION FOR CERTIORARI, PAGE 6.)

The majority opinion of the Circuit Court of Appeals is not clear as to

(a) Whether it found no actual fraud in the pledge purported to be evidenced by the written pledge of the date of April 27, 1926, and the subsequent pledge in July, 1926, of additional securities [although it is stated in said opinion, "We hold that the pledge was valid" (R. 482)]; or

(b) Whether said Court concurred with the trial Court's finding of actual fraud and then sought to avoid the legal effect thereof [by reason that creditor Freeman was estopped to question the validity of the pledge to the respondent company (R. 470, 472)]; or

(c) Whether it found fraud as to other creditors, but held it immaterial because of a supposed lack of pleading and/or proof that there were other creditors existing at the time of said transfers (R. 472, 473).

Because of the aforementioned uncertainty as to whether the Circuit Court of Appeals really found

the facts of fraud contrary to the trial Court's findings, it is necessary to present this branch of the argument as an alternative to the hypothesis that the findings below stood with different conclusions of law drawn from them. If the Circuit Court of Appeals by its majority opinion found fraud, and thereby concurred with the findings of the trial Court, then all of the above are conclusions of law as to the legal effect of the fraud and should be argued as errors of law, and are fully covered herein by the specifications Nos. 4 and 8; but if the majority opinion of the Circuit Court of Appeals found no fraud at all, that is, that the pledges were bona fide, or found that they were lawful preferences, then its conclusions are not supported by the facts and the trial Court's finding of fact on fraud should not be reversed, particularly when such findings are based upon testimony of the bankrupt and the respondent's officers heard and observed and disbelieved by the trial Judge.

The trial Court found that all the transfers involved were made with intent by all parties to hinder, delay and defeat Henry's creditors. The Circuit Court of Appeals erred in reversing such finding (if it did so) by its holding that the pledge bearing the date of April 27, 1926, and the subsequent pledge of additional securities in July, 1926, were valid (R. 482) and at the most constituted preferences in favor of respondent, made with the intent of the respondent and the bankrupt merely to prefer the respondent to other creditors without any intention to hinder, delay or defraud said other creditors (R. 467).

Section 3432* of the Civil Code of the State of California recognizes the validity of a bona fide preference, but Section 3431 of the Civil Code provides:

> "*In the absence of fraud* every contract of a debtor is valid against all his creditors, existing or subsequent, who have not acquired a lien on the property affected by such contract" (italics ours).

The Appellate Courts of the State of California, based upon said section, have definitely held that if the intention of the parties in effecting a preference is not merely to secure to a favored creditor payment of his claim but to help the debtor cover up his property and to keep other creditors from seizing it, or in any other way to hinder, delay or defraud any other creditors, the preference is fraudulent and void and the favored creditor cannot avoid this consequence by showing that he parted with actual value for the conveyance.

See:

Roberts v. Burr, 135 Cal. 156;
In re Muller, 118 Cal. 432;
In re Luce, 83 Cal. 303;
Wolbrecht v. French, 24 Cal. App. 505;
12 *California Jurisprudence,* 1012.

Such creditor receiving the preference must take only enough property to satisfy his debt. In order to sustain a conveyance of a greater amount of property than is necessary to satisfy the demands of the creditor receiving preference, it must be made to

*See section set forth in full in appendix.

appear that the property is of such a nature as to make its severance or division impracticable, or that the debtor intends in good faith to use the proceeds derived therefrom in satisfaction of debts owing to other creditors.

Wolbrecht v. French, 24 Cal. App. 505, at 508;
Becker v. Beldt, 205 Cal. 491, at 494.

This Court has clearly recognized the difference between a preference and a fraudulent conveyance and has held that both may exist under the same set of facts, and further, that if in effecting a preference an actual intent to defraud, hinder or delay other creditors of the bankrupt is present, the same is void as a fraudulent conveyance.

See:

Van Iderstine v. National Discount Co., 227 U. S. 575, 582;
Dean v. Davis, 242 U. S. 438, 444;
Coder v. Arts, 213 U. S. 242, 243, 244.

The trial Court's findings were:

"Moreover, taking into account all the facts and circumstances in evidence, *all that makes for credibility of witnesses and weight to be given to evidence, all the indefinables impressions of the trial, the conviction is compelled that the transfers involved were made with intent by all to hinder, delay and defeat Henry's creditors.* * * * Their more or less contradictory testimony to their own innocency, fails to persuade to outweigh all that gives that sinister aspect to their actions which establish their intent not only to acquire Henry's properties, to satisfy their claims, perhaps to protect him also, but also to foil efforts of his unsecured creditors

to make their claims out of his properties" (R. 34, 35) (italics ours).

The trial Court heard and observed the witnesses (the bankrupt and the officers of the respondent company) and said the evidence and all of the "indefinables impressions of the trial" compelled the conviction that the transfers were made with intent by all parties to hinder, delay and defeat Henry's creditors. This case in this respect is identical with the case of *Davis v. Gates,* 235 Fed. 192, where the Court, on page 199, said:

> "As witnesses the bankrupt and the defendant do not commend themselves to this Court. Their testimony discloses such evasiveness, rashness of statement and inconsistencies and improbabilities as not only to deprive it of weight but strongly to tend to establish the plaintiff's case, even in the absence of opposing evidence."

Likewise, in *Becker v. Beldt,* 205 Cal. 491, in which case the plaintiff sought to have decreed that a preference was made with actual intent to hinder, delay and defraud creditors, and in finding said fraudulent intent the Court in part said, at page 494:

> "As a whole her (referring to the transferee) testimony was evasive and from it the court was justified in concluding in effect that not only did she have knowledge of the fraudulent intent of her brother in making the conveyance to her but that she participated in the carrying out of that fraud by arranging to take the title out of the reach of plaintiffs and give back to her brother a sum of money greater than the amount of the indebtedness found to be owing by him to her."

There is no conflict in the facts or the sequence of the various transactions between the bankrupt and the respondent company, but the only conflict, if any, is in the inferences that may be deduced from these facts. The trial Court in its opinion expressly stated that the "conviction" or inference was compelled "that the transfers involved were made with intent by all parties to hinder, delay and defeat Henry's creditors" after considering not only the facts and circumstances in evidence, but also "all that makes for credibility of witnesses" (the demeanor and conduct of witnesses) and the "weight to be given to evidence" and all the "indefinables impressions of the trial."

The Circuit Court of Appeals did not hear and observe the witnesses, nor were there before it these "indefinables impressions of the trial," and under these circumstances said Court should (as it has repeatedly done heretofore, see cases below) not have been inclined to disturb lightly the findings of the lower Court.

Jones v. Jones, 35 Fed. (2d) 943, 945;
John T. Porter Co., et al. v. Java Cocoanut Oil Co. Ltd., 4 Fed. (2d) 476, 478; certiorari denied, 268 U. S. 697-698;
Ostbern v. Dean, 18 Fed. (2d) 1019, 1020;
Monson v. Hibler, 24 Fed. (2d) 909, 910.

These cases are cited in the dissenting opinion by Circuit Judge Sawtelle (R. 493).

The foregoing may be concluded by referring to the very expressive statement of Judge Sawtelle in his dissenting opinion, to-wit:

> "Such 'indefinable impressions of the trial' are indeed the persuasive imponderables of an equity suit involving fraud" (R. 492).

The mere statement of the facts concerning the events and their sequence is in itself sufficient to affirm the lower Court's findings of intent to defraud, which was clearly expressed by Judge Sawtelle in the dissenting opinion in the following language:

> "The sequence of events * * * clearly discloses a plan to 'freeze out' non-kindred creditors from the family corporation's stock and from other of Henry's assets" (R. 488).

Said statement compels conviction when considered with the fact that by "the sequence of events" all of the bankrupt's property of a value of $180,000.00 was at the date of his adjudication as a bankrupt transferred to and held by the respondent and members of Henry's family, with nothing remaining in the bankrupt's estate with which to satisfy the large amount of his indebtednesses held by his non-kindred creditors.

Positive and direct proof of an intent to hinder, delay or defraud creditors can seldom be obtained, for generally the first effort of a man who intends to commit a fraud is to throw a veil over the transaction, to shield it against assault and baffle all attempts at detection. No man willingly furnishes the evidence of his own turpitude. Fraud is, for this reason, rarely perpetrated openly and in broad daylight. It is committed secretly and privately, and is usually hedged in and surrounded by all the guards which can be invoked to prevent discovery and ex-

posure. Its operations are frequently circuitous and difficult of detection. It is therefore usually established by circumstantial evidence.

Bump on Fraudulent Conveyances, Section 612, page 590.

The following quotation from *Bump on Fraudulent Conveyances,* Section 613, page 591, is a clear statement of the method and quantum of proof required in fraudulent conveyance cases of the intent to defraud, to-wit:

"No transfer is fraudulent unless it is made with an intent to delay, hinder or defraud creditors, and this intent is an emotion of the mind, and can usually be shown only by the acts and declarations of the party. These acts and declarations, and all the concomitant circumstances, must be established, and then the motive may be deduced from them in accordance with those principles which are shown by experience and observation to rule human conduct. The proof in each case will consequently depend upon its own circumstances. It usually consists of many items of evidence which, standing detached alone, would be immaterial, but which, in connection with others, tend to illustrate and shed light upon the character of the transaction and show the position in which the parties stand, and their motives, conduct and relations to each other. *Quae singula non prosunt, juncta juvant.* Although the evidence is generally circumstantial it is often as potent as direct testimony. Sometimes a combination of circumstances characterizes a transaction so plainly and so clearly as to stamp upon it unerring and indelible marks of fraud which can not be mistaken, and the

> transaction itself present phases so remarkable and peculiar that no fair-minded person can hesitate to pronounce it fraudulent. The *indicia* are often the clearest proof and quite as reliable as positive evidence."

It was not necessary to find an actual fraudulent intent. A hindrance by intent but with no fraudulent intent is in principle the same as was found in the most recent reported decision of this Court.

> *Shapiro v. Wilgus,* .. U. S. ..., decided December 5, 1932, No. 40, October Term, 1932.

The fraud presented in this late case was constructive, not actual, consisting in the hindrance of creditors from reaching the debtor's property by the ordinary legal processes. As this Court said, the law stamps a quality upon the act without regard to actual intent to defraud under such circumstances. The analogy between a receivership to ward off executions by creditors and an excessive pledge followed by a surreptitious pledge sale to accomplish that effect is close. In the case at bar pledge was confessedly given because Freeman was pressing and the Barceloux family "made" Henry "give us on April 27, 1926," the pledge agreement; "we just wanted it more explicit," knowing that "there had been a judgment" in favor of Frank Freeman (R. 303). Then very shortly they "wanted" and by agreement Henry gave them "more security," the July pledge of the bank, garage and insurance shares (R. 310). Thereafter no property was left open to execution. Whether or not fraud was intended, hindrance was the result of all these transactions done with knowl-

edge. The case is thus one of constructive fraud within the principles of

Shapiro v. Wilgus, ... U. S. ..., No. 40, October Term, 1932.

And the finding of these facts, inescapable, necessitates the legal conclusion of a conveyance obnoxious to the law. The trial Court's findings and conclusions are supportable on that view.

Irrespective of the "indefinable impressions of the trial," which the trial Court concluded "suffices to condemn," the following circumstances or badges of fraud shown without conflict were disregarded:

1. **Relationship of the parties.**

The respondent, a family corporation, was dominated during the year 1926 by George Barceloux and Cora Gelinas, brother and sister of the bankrupt, and by Henry Barceloux, and for all purposes the corporation may be treated as the Barceloux family. Under local and national law the relationship of the parties subjects the whole transaction to rigid scrutiny, and that fact, when considered with other facts, may be sufficient to condemn.

Evans v. Sparks, 170 Cal. 532, 534;
Davis v. Schwarz, 155 U. S. 631, 638.

Since the bankrupt, being insolvent or in contemplation of insolvency, conveyed his only substantial unencumbered asset to the Barceloux family, the effect of which was to place such property beyond the reach of his creditors, the onus shifted to the respondent to show by satisfactory evidence that the conveyance was based upon a valuable consideration,

free from any fraudulent intention on the part of the debtor, known to or participated in by the respondent, to hinder, delay and defraud his creditors.

Hedrick v. Hockfield, 283 Fed. 574.

This burden the respondent has failed to sustain. On the contrary, the proof supported the findings of the trial Court and of Judge Sawtelle to the effect that the "sequence of events" discloses a plan to "freeze out" non-kindred creditors.

2. That the pledge covered greatly excessive security over and above all indebtedness.

The respondent and bankrupt attempted to consummate a preference by pledging to the respondent securities found by the master to be of the value of $94,949.66, as of August 16, 1926 (R. 61), as security for the three notes set forth in the pledge agreement totalling the sum of $27,814.48, and further, in July, 1926, taking as additional security therefor securities valued by the master at $2,158.00, as of August 16, 1926, when they already claimed security of three times the value of the three notes secured by the pledge (R. 492-493).

Under the local law the conveyance of a greater amount of property than is necessary to satisfy the demand of the creditors receiving the preference is a badge of fraud.

Sukeforth v. Lord, 87 Cal. 399;
Wolbrecht v. French, 24 Cal. App. 505;
Becker v. Beldt, 205 Cal. 491, at 494.

The fact that the transaction was by way of pledge rather than by sale is entirely immaterial, as pointed

out in *Turner v. Jacobs*, 15 F. (2d) 350, at 352 (C. C. A. 5th), and particularly when it may be inferred, as in the case at bar, that the pledgee then contemplated the sale of said securities under a pledge sale which enabled the one creditor to get property worth substantially more than his debt and thereby placed beyond the reach of the other creditors the debtor's only asset of substantial value, which, but for that pledge, could be subjected to the payment of the debts owing to them.

3. Insolvency.

The trial Court found (R. 31) that at the time in question the bankrupt's property was of the value of some $180,000.00, the indebtedness amounting to some $191,000.00, which finding is indisputably supported by proof. In any event the bankrupt at the time in question was insolvent within the meaning of Section 3450 of the Civil Code, which provides:

> "A debtor is insolvent, within the meaning of this title, when he is unable to pay his debts from his own means, as they become due."

4. The taking of additional security when the creditor already holds excessive security.

As heretofore stated, in July, 1926, when the respondent held security of a value of three times the claimed indebtedness, it took additional security for the same indebtedness, having a value of $2,158.00.

The law abhors the practice of one creditor already having excess security piling security upon security, thereby defeating the payment of the just demands

of the debtor's other creditors and, therefore, holds the same to be a badge of fraud.

Jaffray v. Wolf, 4 Okl. 303.

5. Selling securities for indebtedness not secured by the pledge.

(a) The respondent noticed the sale of the securities claimed to be held by it for payment of indebtedness found not to be owing to it, to-wit, an open account for $1,800.00, with interest thereon in the sum of $830.00. Said claim was not due or owing to the respondent but to the heirs of Peter Barceloux, as found by the majority opinion (R. 471).

(b) Respondent also noticed the sale for the payment of interest on an open account in the sum of $1,717.62, when said amount did not bear interest. The law of the State of California is that the balance on an open book account does not bear interest unless there is an express agreement between the parties that the debtor shall pay interest thereon, or unless such agreement be implied from the practice of the parties.

Atkinson v. Golden Gate Tile Co., 21 Cal. App. 168, 172;

Fee v. McPhee Co., 31 Cal. App. 298, 314.

The testimony of George A. Barceloux negatives any agreement to pay interest, in that he testified as follows:

> "A. Well, I figured the date where he first agreed that he owed that money and had not turned back was the date that he should be charged interest, *and if he did not want to pay it he could object to it at the sale"* (R. 320) (italics ours).

(c) The pledge agreement was given to secure three promissory notes. The notice of sale contained in addition to the notes set forth in the pledge agreement, three additional claimed obligations, that is,

½ of a promissory note in the sum of $2,000.00 signed by H. J. Barceloux and George A. Barceloux, dated January 3, 1923, with interest thereon	$1,276.00
Open account of $1,717.62, with interest thereon at $304.18	2,021.80
Open account for $1,800.00 with interest thereon in the sum of $830.00	2,630.00
Making a total of the additional obligations in the sum of	$5,927.80

The pledge agreement provided that upon a sale to satisfy its specific debts, any surplus proceeds could be appropriated to any other debt due the pledgee from Henry. The trial Court found that "payment from surplus, and payment by sale, are quite different." In the latter case it is sale of a pledge for debts other than for which the pledge was made and the transaction is void (R. 34).

Such an agreement to pay from surplus contained in a pledge agreement has been held merely to refer to obligations accruing in the future and not then existing.

Franklin Bank v. Harris, 77 Ind. 423.

(d) The foreclosure of the pledge was further invalid for the reason that although assumed to have been made at public sale, no outcry was given, no bids invited (R. 323), but said stock together with

that of the second pledge was quietly appropriated to the respondent as purchaser thereof for the amount purported due it, and all of which was done after Freeman as the holder of the second pledge had demanded notice of any such sale.

(e) Further, the respondent offered the stocks of four different corporations held by it under the purported pledge agreement *en masse* for the satisfaction of the total indebtedness claimed to be due to it by the bankrupt, which is in violation of Section 694* of the Code of Civil Procedure of the State of California.

See, also:

Barr v. Smith, 97 Cal. App. 398.

6. Secret trusts.

Fraud is generally accompanied by a secret trust and since the debtor must usually select a person in whom he can repose a secret confidence, and the sentiment of affection commonly generates this confidence, it often causes relatives to deal with each other to the detriment of just creditors. When as between members of a family a member will take security in the sum of $97,107.66 belonging to another member to satisfy an obligation in the sum of $27,814.48, necessarily an inference must be deduced that there is some agreement between them that all of the property or a portion thereof will be returned to the debtor when his financial troubles are over and after he has been discharged as a bankrupt. This is

*See section in full in appendix.

more pertinent in the case at bar in that all of the bankrupt's properties of a value of $180,000.00 were transferred to his family, leaving nothing from which the non-kindred creditors could satisfy their obligations.

In view of the circumstances and badges of fraud revealed from the testimony of the transferor and transferee of these fraudulent transactions, the Circuit Court of Appeals erred in disturbing the trial Court's finding on fraud, and especially so when said Appellate Court did not have the advantage of hearing and observing the witnesses and those things "that makes for credibility of witnesses," and when these intangibles, or, as expressed by the trial Court, "the indefinable impressions" which in themselves in the trial Court's opinion sufficed to condemn the transactions.

In an equity appeal the findings of fact are not beyond review to the same degree as on appeals at law. Nevertheless, in an equity appeal such findings are not to be disturbed lightly or unless clearly wrong and manifestly erroneous, as already stated.

Another applicable rule is that a master's findings approved by the trial Court are treated as prima facie correct and will not be set aside unless clearly wrong.

Barger v. National Discount Corp., 33 F. (2d) 511;

Schock v. Malloy, 26 F. (2d) 621, 623 (citing many cases).

It is only when a very strong appearance of error in findings exists in the record that the reviewing

Court will overturn the trial Court's findings, such a case, for example, as

Harkin v. Brundage, 276 U. S. 36, 53,

in which Chief Justice Taft, for this Court, set aside the findings below.

No such manifest error appears by the record here. It cannot be said that the trial Court's findings of fraud were baseless inferences and manifestly erroneous, even if the Circuit Court of Appeals as a trial Court might have drawn other inferences. Moreover, in one particular the referee and the trial Court concurred in finding the value of the transferred shares to be a sum more than three times as great as the debt claimed by the transferee, respondent here. That value as found by the referee was excepted to on the incoming of his report (R. 65 to 82) and was confirmed (R. 103) in that respect. This unconscionable disparity between the claim of debt and the proved value, doubly found, should not lightly be disregarded.

CONCLUSION.

It is therefore respectfully submitted that this Court should reverse the decision of the Circuit Court of Appeals and that the cause, upon such reversal being made, should be remanded direct to the District Court, in accordance with U. S. Code, Title 28, Section 877 (Act of March 3, 1891, c. 517, Sec. 10), affirming the judgment of the District Court, as was done in *Delk v. St. Louis & S. F. R. Co.*, 220 U. S. 850.

Dated, San Francisco, California,
February 10, 1933.

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(Appendix Follows.)

Appendix

California Civil Code, Section 3439:

"Every transfer of property or charge thereon made, every obligation incurred, and every judicial proceeding taken, with intent to delay or defraud any creditor or other person of his demands, is void against all creditors of the debtor, and their successors in interest, and against any person upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor."

California Civil Code, Section 3440, first paragraph:

"Every transfer of personal property, other than a thing in action, or a ship or cargo at sea or in a foreign port, and every lien thereon, other than a mortgage, when allowed by law, and a contract of bottomry or respondentia, is conclusively presumed if made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery, and followed by an actual and continued change of possession of the things transferred, to be fraudulent, and therefore void, against those who are his creditors while he remains in possession, and the successors in interest of such creditors, and against any persons on whom his estate devolves in trust for the benefit of others than himself, and against purchasers or encumbrancers in good faith subsequent to the transfer."

California Civil Code, Section 309, as it stood in 1926:

"Unless they shall have been first permitted or authorized so to do by the commissioner of corporations, directors of corporations must not make dividends except from the surplus profits arising from the business thereof; nor must they create any debts beyond their subscribed capital stock; *nor must they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock, except as hereinafter provided, nor reduce or increase the capital stock,* except as provided in section three hundred fifty-nine of this code. For a violation of the provisions of this section, the directors under whose administration the same may have happened (except those who may have caused their dissent therefrom to be entered at large on the minutes of the directors at the time, or were not present when the same did happen) are, in their individual or private capacity, jointly and severally liable to the corporation, and to the creditors thereof, to the full amount of the capital stock so divided, withdrawn, paid out, or reduced or debt contracted. Nothing herein prohibits a division and distribution of the capital stock of any corporation which remains after the payment of all its debts, upon its dissolution, or the expiration of its term of existence" (italics ours).

California Civil Code, Section 342 (enacted 1931):

"No corporation shall purchase or agree to purchase, or cause or permit any corporation which it controls to purchase or agree to purchase, or employ or assist any person or corporation to purchase or agree to purchase for its account any of its shares except as follows:

(1) *To collect or compromise in good faith, a debt,* claim or controversy with any shareholder;

(2) *From shareholders who by reason of dissent* are entitled to be paid the fair cash value of their shares;

(3) *From one who as an employee other than as an officer* or director has purchased such shares from the corporation under an agreement reserving to the corporation the option to repurchase or obligating it to repurchase;

(4) *To eliminate fractional shares;*

(5) *To purchase shares subject to redemption* at prices not exceeding the redemption price thereof;

(6) *To carry out provisions of its articles authorizing conversion* of its shares; and

(7) *Subject to limitations, if any, contained in its articles,* only from earned surplus.

A corporation shall not purchase its own shares of any class in any case when there is reasonable ground for believing that the corporation is unable, or, by such purchase, will be rendered un-

able, to satisfy its debts and liabilities when they fall due. Nothing in this section shall be construed to prevent a corporation from acquiring its own shares by gift or bequest or upon a merger with or distribution of the assets of another corporation (added by Stats. 1931, p. 1800)."

California Civil Code, Section 2993:

"A pledgor and pledgee may agree upon a third person with whom to deposit the property pledged, who, if he accepts the deposit, is called a pledge-holder."

California Civil Code, Section 2988:

"The lien of a pledge is dependent on possession, and no pledge is valid until the property pledged is delivered to the pledgee, or to a pledge-holder, as hereafter prescribed."

California Civil Code, Section 3432:

"A debtor may pay one creditor in preference to another, or may give to one creditor security for the payment of his demand in preference to another."

California Code of Civil Procedure, Section 694:

"All sales of property under execution* must be made at auction, to the highest bidder, between the hours of nine in the morning and five in the

*(Note. Made applicable to pledge sales by California Civil Code, Section 3005: "The sale by pledgee, of property pledged, must be made by public auction, in the manner and upon the notice of sale of personal property under execution.")

afternoon. *After sufficient property has been sold to satisfy the execution, no more can be sold.* Neither the officer holding the execution nor his deputy can become a purchaser or be interested in any purchase, at such sale. When the sale is of personal property, capable of manual delivery, it must be within view of those who attend the sale, *and be sold in such parcels as are likely to bring the highest price;* [portion relating to sales of real property omitted]. The judgment debtor, if present at the sale, may also direct the order in which property, real or personal, shall be sold, when such property consists of several known lots or parcels, or of articles which can be sold to advantage separately, and the sheriff must follow such directions" (italics ours).